



Office of Inspector General

July 2006
Report No. 06-014

**The FDIC's Industrial Loan Company
Deposit Insurance Application Process**

EVALUATION REPORT

Office of Audits



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Background and Purpose of Evaluation

Industrial Loan Companies (ILC) are FDIC-supervised, limited-charter depository institutions. ILCs may be owned by commercial firms, and these parent companies may not be subject to consolidated supervision by a federal regulator. As of March 2006, there were 61 ILCs with total assets of \$155 billion.

The FDIC solely grants deposit insurance and evaluates whether an ILC application for deposit insurance meets statutory factors. After approving the application, the FDIC issues an Order for insurance that includes standard conditions and, if warranted, includes nonstandard conditions.

The FDIC uses conditions to impose restrictions and establish operating parameters and controls on ILCs, including business plan limitations. The FDIC may also impose certain types of nonstandard conditions on ILCs, known as prudential conditions, which are related to separating and insulating an ILC from its parent company.

The objective of this evaluation was to evaluate the FDIC's process for (1) reviewing, investigating, and approving ILC applications for deposit insurance and (2) monitoring business operations to ensure adherence to conditions imposed on ILCs. We placed particular emphasis on the FDIC's monitoring of conditions associated with ILC business plans.

The FDIC's Industrial Loan Company Deposit Insurance Application Process

Results of Evaluation

The FDIC has implemented a comprehensive process and procedures for reviewing, investigating, and approving deposit insurance applications, which include: (1) holding pre-filing meetings with applicants; (2) evaluating and investigating the application against seven statutory factors; (3) reviewing and assessing the applicant's proposed business plan; (4) reviewing and processing the application at the regional office level; and (5) preparing an Order for deposit insurance containing conditions on applicant operations. For ILCs, the process also includes application review and approval at the FDIC headquarters level.

Historically, the FDIC has maintained that it can impose conditions to ensure sufficient autonomy and insulation of an ILC from its parent and to adequately protect the ILC from the risks of being in a holding company not subject to consolidated supervision. In that regard, the Corporation issued guidance in March 2004 that emphasized the use of prudential conditions when approving applications for deposit insurance for financial institutions that will be owned by, or significantly involved in, transactions with commercial or financial companies.

During this evaluation, the FDIC indicated that conditions associated with the granting of deposit insurance are legally binding and are principally intended to notify the applicant of the FDIC's operational expectations. FDIC officials stressed, however, that examinations and offsite monitoring activities are the primary means through which the FDIC ensures the safety and soundness of ILCs.

Based on our review of 12 ILC applications and 18 Orders for deposit insurance, we found that the FDIC followed most of its deposit insurance application procedures and routinely imposed conditions associated with the granting of deposit insurance. We made the following observations:

- The FDIC did not always document or provide the results of pre-filing meetings to examiners conducting field investigations. Documentation and distribution of the results of pre-filing meetings would help to ensure that potential concerns with an application are promptly and effectively addressed during the field investigation.
- In the Orders that we reviewed, the FDIC imposed most conditions on the ILC as opposed to the ILC parent. FDIC officials have stated that conditions imposed upon an ILC parent provide the FDIC with a means for requiring the parent company to adopt commitments, operations, and procedures that enhance the safety and soundness of the ILC. The FDIC could also impose conditions that require the parent company to provide information to facilitate the examiner's ability to assess the various types of risk from the parent company and affiliate operations.

OIG Recommendations

We are making six recommendations to strengthen the ILC deposit insurance application process and subsequent monitoring of ILC conditions and business operations. The recommendations address our observations associated with:

- documenting pre-filing meetings;
- imposing conditions associated with deposit insurance applications;
- obtaining the applicant's agreement in writing to nonstandard conditions, and confirming the applicant's compliance with conditions;
- clarifying corporate guidance for investigating the possible impact of an applicant's proposed line of business on existing financial institutions and the Deposit Insurance Fund; and
- addressing the status of conditions in visitation reports and Reports of Examination.

The FDIC concurred with each of our recommendations and agreed to take action to address four of the recommendations by December 31, 2006 and the two remaining recommendations by June 30, 2007.

To view the full report, go to www.fdicig.gov/2006reports.asp

Results of Evaluation (Continued)

- The FDIC imposed conditions requiring ILCs to notify or seek FDIC approval before making significant business plan changes. We confirmed that the Corporation could pursue enforcement action should an ILC fail to notify the FDIC before changing its business plan, based solely on the violation of such a condition. Further, FDIC officials stated that the Corporation can deny an ILC's request for a business plan change as long as there is a reasonable basis for challenging the change—such as a safety and soundness issue or violation of law or regulation.
- The FDIC imposed one prudential condition in the Orders that we reviewed. In some cases, the Chartering State Authority imposed conditions that were similar in nature to the FDIC's prudential conditions. However, the state conditions were associated with the granting of the charter, not deposit insurance, and the FDIC cannot directly enforce state-imposed conditions. In response to our observation, FDIC officials stated that the Corporation imposes conditions on a case-by-case basis, as it deems appropriate, based on risks presented by an applicant's proposal.
- The FDIC did not always have evidence in its files that the Corporation had (1) obtained the applicant's agreement in writing to nonstandard conditions included in the deposit insurance Order or (2) confirmed that the applicant had complied with, or had made arrangements to comply with, all conditions before issuing the deposit insurance Order.
- The FDIC needs to issue guidance to (a) clarify corporate expectations for investigating the probable impact of an applicant's proposed business line on existing financial institutions and, ultimately, risk to the Deposit Insurance Fund, and (b) emphasize that examiners document the basis for their conclusions on an applicant's compliance with those factors.

Following the approval of an ILC deposit insurance application, the FDIC monitors ILC business operations through onsite examinations and offsite supervisory programs. The Corporation's monitoring processes provide a reasonable supervisory approach to help ensure that ILCs adhere to the conditions imposed upon them, including those associated with business plans. However, the FDIC did not always address the status of conditions in visitation or examination reports, which could hamper offsite monitoring of compliance.

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ACRONYMS

CMLA	Capital Maintenance and Liquidity Agreement
CMP Manual	Case Manager Procedures Manual
DFI	Department of Financial Institutions (Utah)
DSC	Division of Supervision and Consumer Protection
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
GAO	Government Accountability Office
ILC	Industrial Loan Company
LIDI	Large Insured Depository Institution
OIG	Office of Inspector General
ORL	Offsite Review List
PBO	Parallel Banking Organization
RDM	Regional Director Memorandum
RMAS	Risk Management Application Section
RM Manual	Risk Management Manual of Examination Policies
ROE	Report of Examination
ROI	Report of Investigation
SOI	Summary of Investigation
ViSION	Virtual Supervisory Information On the Net System



DATE: July 20, 2006

MEMORANDUM TO: Sandra L. Thompson
Acting Director
Division of Supervision and Consumer Protection

FROM: Russell A. Rau [Electronically produced version; original signed by Russell A. Rau]
Assistant Inspector General for Audits

SUBJECT: *The FDIC's Industrial Loan Company Deposit Insurance Application Process*
(Report No. 06-014)

Industrial Loan Companies (ILC) are state-chartered, FDIC-supervised financial institutions that may be owned by commercial firms that are not regulated by a federal banking agency.¹ The ILC charter has received considerable attention in recent years as part of the ongoing debate about the mixing of banking and commerce. Our previous review of ILCs focused on the FDIC's supervision of ILCs and the Corporation's approach in determining and mitigating material risks posed to ILCs by parent companies. We presented the results of that review in the Office of Inspector General (OIG) September 2004 report entitled, *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions* (Report No. 2004-048).

The objective of this evaluation was to evaluate the FDIC's process for (1) reviewing, investigating, and approving ILC applications for deposit insurance and (2) monitoring business operations to ensure adherence to conditions imposed on ILCs. Appendix I includes additional details on our objective, scope, and methodology.

BACKGROUND

The FDIC is solely authorized to approve applications for deposit insurance, including ILC applications. In the case of ILCs, the chartering authority is the respective state regulatory agency. Approvals must be granted by the FDIC and the Chartering State Authority for an ILC to accept insured deposits. The FDIC is the primary federal regulator of ILCs. The Chartering State Authority also has responsibility for supervising and monitoring the ILCs in the respective state.

¹ Parent companies of ILCs may be subject to other federal agency supervision such as by the Office of Thrift Supervision (for parent companies affiliated with savings institutions) or oversight by the Securities and Exchange Commission (for parent companies that are publicly traded).

The Board of Directors of the FDIC (FDIC Board) is charged by Sections 5 and 6 of the Federal Deposit Insurance (FDI) Act with the responsibility of acting on applications for federal deposit insurance by all depository institutions, including ILCs. The FDIC Board delegated this responsibility to the Division of Supervision and Consumer Protection (DSC), but the FDIC Board retained the authority to deny applications for deposit insurance and to approve deposit insurance where either the applicant does not agree in writing to comply with any condition imposed by the FDIC or the applicant is part of a parallel-owned banking organization (PBO).²

In considering applications for deposit insurance, DSC must evaluate each application in relation to the seven statutory factors prescribed in Section 6 of the FDI Act.³ Those factors are:

- the financial history and condition of the proposed depository institution;
- the adequacy of its capital structure;
- its future earnings prospects;
- the general character and fitness of its management;
- the convenience and needs of the community to be served by the depository institution;
- the risk presented by such depository institution to the deposit insurance fund; and
- whether its corporate powers are consistent with the purposes of the FDI Act.

The FDIC has provided general information and instructions for completing and submitting applications for deposit insurance through its regulations, statement of policy on applications,⁴ and deposit insurance application form. An application for deposit insurance requires the submission of a comprehensive business plan that establishes the proposed institution's goals and objectives, addresses the first 3 years of operations, and provides detailed explanations of proposed actions for accomplishing the primary functions of the institution. The business plan should provide sufficient detail to demonstrate that the institution has a reasonable chance for success, will operate in a safe and sound manner, and will have adequate capital to support the institution's risk profile.

Upon approval of the application, the FDIC issues an Order for deposit insurance that includes standard conditions and may include nonstandard conditions. Conditions are derived from the elements of a proposal that raise supervisory concern or otherwise warrant attention. Among the primary considerations for conditions are the nature and scope of the business plan, the corporate structure within which the financial institution will operate, and the risk inherent in the overall proposal. The FDIC uses conditions to impose restrictions and to establish operating parameters and controls on the institution for a set period of time—usually up to the first 3 years of operation—or for an indefinite period of time. Appendix II describes the types of conditions that the FDIC may impose when approving deposit insurance applications.

² A PBO is created when at least one U.S. depository institution and one foreign bank are controlled either directly or indirectly by the same person or group of persons who are closely associated in their business dealings or otherwise acting in concert.

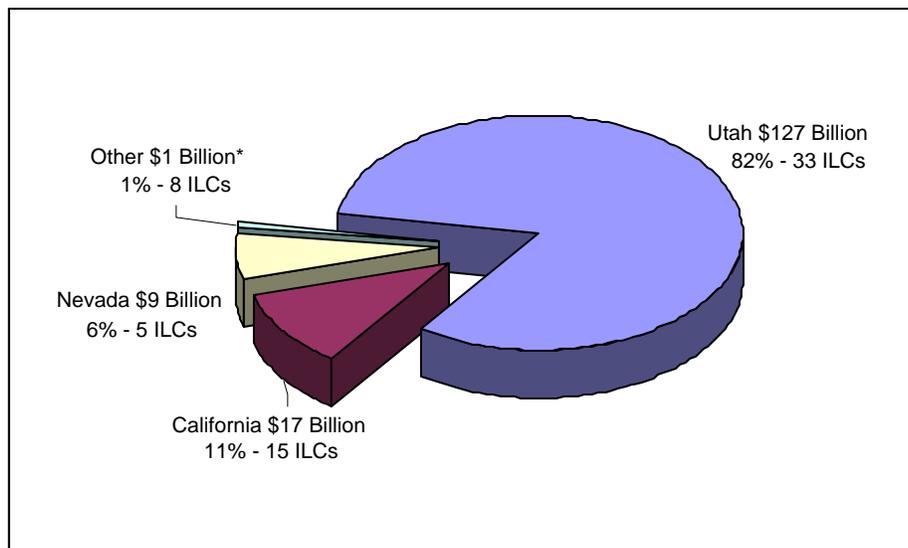
³ In addition to the statutory factors, the considerations required by the National Historic Preservation Act of 1966 and the National Environmental Policy Act of 1969 must also be resolved favorably in order for the applicant to receive deposit insurance.

⁴ *FDIC Statement of Policy on Applications for Deposit Insurance*, effective October 1, 1998, amended at 67 Fed. Reg. 79278, December 27, 2002.

One of the requisites for obtaining deposit insurance is that the applicant has been granted a charter by the appropriate state or federal supervisory authority.⁵ A charter is a legal authorization from the state or federal agency giving a bank the authority to commence business. Each Chartering State Authority is subject to its own governing statutes and regulations, which vary by state. Chartering State Authorities are solely responsible for chartering decisions, whereas the FDIC is solely responsible for deposit insurance decisions. These decisions are separate and distinct. The FDIC and Chartering State Authorities have established cooperative arrangements that begin with the initial contacts from applicants and extend through the application process.

As of March 31, 2006, there were 61 ILCs located in 7 states with total assets of \$155 billion as illustrated in the figure below. Utah chartered the greatest number of ILCs (54 percent) and the majority of ILC assets (82 percent).

Distribution of ILC Assets by Charter State



Source: OIG analysis of DSC's listing of ILCs.

Note: Other states chartering ILCs are Hawaii, Colorado, Minnesota, and Indiana.

Numbers do not total \$155 billion due to rounding.

During the 5-year period December 2000 through December 2005, the FDIC approved deposit insurance applications for 780 institutions, of which 19 were for ILCs. During the same period, 105 applications for deposit insurance were withdrawn by the applicants, of which 12 were ILC applicants. Three of the twelve withdrawn applications were subsequently re-filed and approved for deposit insurance. DSC noted that it is rare for the FDIC to deny an application, because most applicants usually withdraw troubled applications before they reach the stage of approval or denial.

⁵ Chartering State Authorities grant charters to financial institutions, including ILCs. The Office of the Comptroller of the Currency is responsible for chartering all national banks.

In our previous report on the FDIC's supervision of ILCs, we concluded that ILCs may pose additional risks to the deposit insurance fund by virtue of the fact that these depository institutions' parent holding companies are not always subject to the scope of consolidated supervision, consolidated capital requirements, or enforcement actions imposed on parent organizations subject to the Bank Holding Company Act of 1956. Further, the banking organizations that are being created as a result of an ILC charter are permitted some mixing of banking and commerce activities, which is otherwise prohibited for most depository institutions owned by commercial firms. However, we concluded that DSC had established controls to help mitigate these added risks.

RESULTS OF EVALUATION

The FDIC has implemented a comprehensive process and procedures for reviewing, investigating, and approving deposit insurance applications, which include: (1) holding pre-filing meetings with applicants; (2) evaluating and investigating the application against seven statutory factors; (3) reviewing and assessing the applicant's proposed business plan; (4) reviewing and processing the application at the regional office level; and (5) preparing an Order for deposit insurance containing conditions on applicant operations. For ILCs, the process also includes application review and approval at the FDIC headquarters level.

In our review of 12 ILC applications, we noted that case managers, examiners, and Washington Office staff, for the most part, followed established policies and procedures in performing reviews, investigations, and analyses involved in the process. However, the FDIC could strengthen the following elements of the deposit insurance application process: documenting pre-filing meetings; clarifying the importance of and need for conditions associated with deposit insurance applications; and clarifying expectations for deposit insurance investigations in evaluating the probable impact of an applicant's business line on existing financial institutions in the community to be served.

Following the approval of an ILC deposit insurance application, the FDIC monitors ILC business operations through onsite examinations and offsite supervisory programs. The Corporation's monitoring processes provide a reasonable supervisory approach to help ensure that ILCs adhere to the conditions imposed upon them, including those associated with business plans. However, the FDIC could more fully address the status of conditions in visitation and examination reports.

NEW BANK APPLICATION PROCESS

The FDIC evaluates applications for deposit insurance against the requirements and processes of Sections 5 and 6 of the FDI Act, Sections 303.20-25 (*Deposit Insurance*) of the FDIC Rules and Regulations, and the *FDIC Statement of Policy on Applications for Deposit Insurance*. The FDIC also issued the following guidance to DSC staff for evaluating deposit insurance applications:

- *Case Manager Procedures Manual*, (CMP Manual) Part II – *Applications*. Section 20, *Applications Overview*, includes case manager responsibilities and an overview of the application process. Section 21, *Federal Deposit Insurance*, discusses application types, receipt and acceptance, statutory factors, field investigations, and delegated authority.
- *Risk Management Manual of Examination Policies*, (RM Manual) Chapter 12.1 – *Applications*, and Chapter 18.1 – *Report of Investigation (ROI) Instructions*. Chapter 12.1 includes a discussion of an examiner’s responsibility in regard to investigating an application against the seven statutory factors. Chapter 18.1 provides general instructions for conducting field investigations and preparing ROIs and provides that the ROI should detail the relevant facts pertinent to each of the statutory factors and state the examiner’s opinion as to whether the criteria for each factor has been met.
- Regional Director Memorandum (RDM) 2004-011, *Imposition of Prudential Conditions in Approvals of Applications for Deposit Insurance*, dated March 12, 2004. This RDM discusses prudential conditions that might be imposed in approving applications for deposit insurance involving financial institutions to be owned by or significantly involved in transactions with commercial or financial companies, should the risk characteristics of a given proposal, including an ILC proposal, warrant such action. See Appendix III for details.
- RDM 2004-012, *Guidance Related to Parallel-Owned Banking Organizations*, dated March 24, 2004. This RDM describes procedures to be used by examiners and case managers when evaluating a bank’s organizational structure and assessing its relationship, existing or potential, with companies that may be part of a PBO. The procedures described in this RDM are applicable for reviewing deposit insurance applications and conducting safety and soundness visitations and examinations.

The intention of this guidance is to ease administration, prevent arbitrary judgment, and assure uniform and fair treatment of all applicants. Table 1 on the next page presents a brief discussion of each statutory factor and examples of steps that an examiner may take to evaluate each factor.

Table 1: Statutory Factors and Examples of FDIC Evaluation Steps

Statutory Factors	Examples of Investigative Steps to Evaluate Application
<p>Financial History and Condition—The primary areas of consideration are the ability of organizers and incorporators of the proposed depository institution to provide financial support to the new institution; investment in fixed assets, including lease obligations; and insider transactions.</p>	<ul style="list-style-type: none"> ▪ Assess the applicant’s projected asset and deposit mix for reasonableness as compared to the proposed business plan and an appropriate peer group. ▪ Construct the projected balance sheet for the first 3 years of operation.
<p>Adequacy of the Capital Structure—Normally, the initial capital of a proposed depository institution should be sufficient to provide a Tier 1 capital-to-assets leverage ratio of not less than 8.0% throughout the first 3 years of operation. In addition, the depository institution must maintain an adequate allowance for loan and lease losses.</p>	<ul style="list-style-type: none"> ▪ Using capital data contained in the application, construct a proposed capital structure table. ▪ Assess the deposit forecasts and make any necessary adjustments.
<p>Future Earnings Prospects—The FDIC must have reasonable assurance that the new institution can be operated profitably. Therefore, the incorporators will need to demonstrate through realistic and supportable estimates that, within a reasonable period (normally 3 years), the earnings of the applicant will be sufficient to provide an adequate profit.</p>	<ul style="list-style-type: none"> ▪ Determine whether the proposed bank is likely to be profitable within a reasonable period of time, usually 3 years. ▪ Evaluate applicant’s projections.
<p>General Character and Fitness of Management—The FDIC evaluates the applicants’ proposed management structure, including individual managers’ business experience, financial responsibility, reputation, and familiarity with the community in which the depository institution will operate.</p>	<ul style="list-style-type: none"> ▪ Provide an overall assessment of the management team and board of directors. ▪ Conduct personal interviews with all of the organizers, senior management, and directors.
<p>Risk Presented to the Insurance Fund—The FDIC must be assured that the proposed institution does not present an undue risk to the insurance fund. In making this determination, the FDIC will rely on any information available to it, including, but not limited to, the applicant’s business plan.</p>	<ul style="list-style-type: none"> ▪ Assess the proposed institution’s business plan, particularly any unsound activities, practices, or other issues. ▪ Address any high-risk activity to establish market share, attain growth, or provide for profitable operations.
<p>Convenience and Needs of the Community to be Served—The essential considerations in evaluating this factor are the deposit and credit needs of the community to be served, the nature and extent of the opportunity available to the applicant in that location, and the willingness and ability of the applicant to serve those financial needs.</p>	<ul style="list-style-type: none"> ▪ Assess the competitive dynamics of the proposed market, how the institution will compete for market share, and the probable impact of the proposed business line on other banks in the community. ▪ Solicit the views of other bankers and, as necessary, representative business and professional persons in the community together with those of citizens of more modest means.
<p>Consistency of Corporate Powers—No insured state bank may engage in any type of activity that is not permissible for a national bank unless the FDIC has determined that the activity would pose no significant risk to the deposit insurance fund and the state bank is in compliance with applicable capital standards.</p>	<ul style="list-style-type: none"> ▪ Determine whether the applicant’s Articles of Incorporation contain any corporate powers that are inconsistent with the FDI Act.

Source: OIG analysis of *FDIC Statement of Policy on Applications for Deposit Insurance* and RM Manual.

The application process involves field examiners, regional case managers, and Washington Office participation from DSC’s Risk Management Application Section (RMAS) and FDIC’s Legal Division. Table 2 presents the key events in the application review and approval process.

Table 2: FDIC’s ILC Deposit Insurance Application Process

Key Event	Description
Holding a pre-filing meeting	The FDIC holds pre-filing meetings with organizers and incorporators of proposed depository institutions prior to submission of the deposit insurance application to discuss the FDIC’s expectations for bank directors and senior management, business plan and capital requirements, and the regulatory application/examination process.
Reviewing application for completeness	A regional office case manager performs the initial review of the application and prepares a summary memorandum describing the business plan and proposed ILC management and renders a decision on the application’s completeness. The case manager forwards the summary memorandum to regional office and headquarters senior management for review and concurrence. The case manager returns the application if it is not complete.
Processing the application through a regional office and DSC headquarters parallel review	Applications that will be approved in DSC headquarters receive parallel processing. Results of the pre-filing meeting with a prospective ILC are relayed to DSC headquarters. The regional office coordinates with the Washington Office concerning any additional information needed from the applicant.
Conducting a field investigation to evaluate an application against the seven statutory factors, including a review of the proposed business plan	A field office examiner reviews the entire application and business plan to identify potential problems, incomplete or inconsistent information, areas of non-compliance with the Statement of Policy and/or federal and state banking statutes, and any other factors requiring additional attention. The examiner prepares an ROI, which details the relevant facts pertinent to each of the seven statutory factors, whether each factor has been favorably resolved, and a recommendation on the approval of the application.
Reviewing the completed ROI and preparing the summary of investigation (SOI)	The case manager reviews the ROI for accuracy and consistency with FDIC policy. The case manager prepares an SOI, which summarizes the major findings of the investigation as they relate to each of the statutory factors and concludes with a statement as to whether the finding is Favorable, Unfavorable, or Favorable Subject to Conditions. The case manager also makes a recommendation on the approval of the application. Regional office management reviews the SOI and makes recommendations for application approval.
Preparing an Order for deposit insurance containing standard and prudential or other nonstandard conditions	RMAS in DSC headquarters reviews the ROI and SOI and prepares the Order for deposit insurance. RMAS may impose additional standard and nonstandard conditions (including prudential conditions). Conditions may be precedent in nature (the applicant must meet the condition before being granted deposit insurance) or antecedent in nature (the applicant must continue to meet the condition following the granting of deposit insurance).
Obtaining an applicant’s written agreement to prudential and other nonstandard conditions	As the applicant’s primary point of contact, the regional office obtains the applicant’s written agreement to prudential and other nonstandard conditions.
Acquiring evidence of the applicant’s compliance with or definite and certain arrangements to comply with the conditions in the Order	The regional office verifies the compliance with time-specific conditions prior to the institution’s opening based upon the financial institution’s submission of information and supporting documentation that is sufficient to demonstrate compliance with the conditions.

Source: OIG analysis of the CMP Manual and the RM Manual and interviews with DSC officials.

The FDIC processes ILC applications similarly to non-ILC applications for deposit insurance with two important exceptions. First, ILC applications are subject to parallel, or concurrent,

processing by the applicable regional office and DSC’s Washington Office. Second, DSC’s Washington Office retains the authority to approve ILC Orders for insurance.

Although applicants are required to satisfy requirements under each of the seven statutory factors, in a newly organized institution, the FDIC views management, capital adequacy, and risk to the fund as the most important factors. DSC’s guidance in regard to applications states that the quality of an institution’s management is vital and may be the most important element in determining the applicant’s acceptability for deposit insurance.

As shown in Table 1, the statutory factors and DSC’s guidance for evaluating applications address the applicant, for the most part. However, the FDIC does consider the parent company in some instances in assessing the statutory factors. For example, DSC’s guidance states that the ability of “the proponents” to provide financial support to the new organization should be evaluated in the assessment of the *Financial History and Condition* statutory factor.

We reviewed 12 ILC applications and noted that case managers, examiners, or Washington Office staff followed most of the applicable procedures when reviewing, investigating, and approving deposit insurance applications as presented in Table 3. The detailed results of our review in this area are included in Appendix IV of this report.

Table 3: Results of OIG Review of ILC Deposit Insurance Application Files

Application Processing Steps	Cases Showing Evidence of Processing Step Performed
Holding a pre-filing meeting	7 of 12
Reviewing the application for completeness	12 of 12
Processing the application at the regional and Washington Office level	12 of 12
Conducting a field investigation and a review of the proposed business plan	11 of 12
Reviewing the report of investigation and preparing the summary of investigation	12 of 12
Preparing a deposit insurance Order containing standard and nonstandard conditions	12 of 12
Obtaining applicant’s written agreement to nonstandard conditions	6 of 10
Acquiring evidence of applicant’s compliance with the conditions in the Order	5 of 12

Source: OIG analysis of examiner, case manager, and RMAS files.

However, the following elements of the process could be strengthened: documenting and transmitting the results of pre-filing meetings, imposing conditions, obtaining an applicant’s written agreement to nonstandard conditions, confirming an applicant’s compliance with conditions, and assessing an applicant’s probable impact on existing banks in the community to be served. These areas are discussed in more detail in the following sections.

Documenting and Transmitting Results of Pre-filing Meetings

In our review of 12 ILC applications for deposit insurance, we found that DSC did not always document pre-filing meetings. When DSC had prepared pre-filing meeting memoranda, they were not distributed to examiners conducting the field investigations for deposit insurance applications. DSC's policies do not require the documentation and distribution of pre-filing meetings. However, the field investigation process could be enhanced by instituting such a requirement to help ensure that identified concerns are addressed in the investigation.

The CMP Manual recommends that DSC conduct pre-filing meetings for all insurance applications and states, "It is strongly recommended that a representative(s) of the organizing group meet with the chartering authority and the FDIC prior to filing an application to reach an understanding of the information requirements of each agency." The CMP Manual also states that, during pre-filing meetings, DSC should notify applicants that:

- certain conditions requiring an applicant's prior written agreement (nonstandard conditions) may be imposed;
- recommended conditions are intended to achieve a standard for prudent operations that is expected of all newly insured institutions;
- conditions may be imposed beyond the institution's initial 3-year period of operation; and
- liquidity and/or capital maintenance agreements with proposed institutions' parent companies may be necessary.

DSC documented the results of a pre-filing meeting for 5 of the 12 ILCs in our sample. For two of the remaining seven ILC applicants for which we did not locate records of pre-filing meetings, DSC provided other evidence that the pre-filing meeting had occurred. The documentation for only one pre-filing meeting noted that DSC had discussed the potential imposition of nonstandard conditions as stipulated in the CMP Manual. The memoranda and notes we reviewed typically did not discuss whether DSC had notified the applicants of the purpose of conditions, certain conditions that may be imposed, certain conditions that may be imposed beyond the bank's initial 3-year period of operation, and liquidity and/or capital maintenance agreements that may be necessary. Furthermore, for those pre-filing meetings that were documented, the memoranda or notes had not been distributed to the examiners conducting the field investigations.

DSC's policies do not require that the results of a pre-filing meeting be documented or that the pre-filing meeting memorandum be distributed to examiners. Pre-filing meetings are, in large part, intended to improve the quality and completeness of submitted applications. However, an underlying purpose of pre-filing meetings is to expeditiously identify and address concerns. To the extent that potential concerns are identified and require further review or consideration during the field investigation, formal documentation and distribution of the pre-filing meeting results would help to ensure that those potential concerns are promptly and effectively addressed during the field investigation.

Recommendation

We recommend that the Acting Director, DSC:

1. Require that pre-filing meetings be documented and that DSC include the results of the pre-filing meetings in the application material submitted to examiners responsible for conducting field investigations of deposit insurance applications.

Imposing Conditions Associated with Deposit Insurance Orders

Historically, the FDIC has maintained that it can impose conditions to preserve an ILC's autonomy and insulate an ILC from its parent and protect an ILC from the risks of being in a holding company not subject to consolidated supervision. During this evaluation, the FDIC indicated that conditions associated with the granting of deposit insurance are legally binding and are principally intended to notify the applicant of the FDIC's operational expectations. FDIC officials stressed, however, that examinations and offsite monitoring activities are the primary means through which the FDIC ensures the safety and soundness of ILCs.

We found that the FDIC routinely imposed standard and nonstandard conditions as part of the 18 ILC Orders for deposit insurance that we reviewed. Appendix V and Appendix VI provide details regarding the conditions imposed in the Orders we reviewed. We also made the following observations in regard to these imposed conditions.

- The FDIC imposed most conditions on the ILC rather than on a parent company.
- The FDIC imposed business plan conditions requiring ILCs to notify or seek FDIC approval before making significant business plan changes.
- The FDIC imposed one prudential condition in the ILC deposit insurance Orders that we reviewed. In a number of cases, the Chartering State Authority imposed conditions similar in nature to prudential conditions.

The following sections of this report discuss each of these issues in more detail.

Importance of Conditions in Monitoring ILC Operations: Conditions may be standard or nonstandard (the applicant must provide written agreement to a nonstandard condition) and precedent (the applicant must meet the condition before being granted deposit insurance) or antecedent (the applicant must continue to meet the condition following the granting of deposit insurance) in nature. The appropriate regional or area office is responsible for verifying compliance with time-specific conditions prior to an institution's opening. Such verifications are based upon the financial institution's submission of information and supporting documentation that is sufficient to demonstrate compliance with the conditions.

Historically, the FDIC has maintained that its authority to impose conditions associated with the granting of deposit insurance was one important way that the FDIC could insulate an ILC from its parent. The following examples illustrate the FDIC's position on this matter in the past.

- April 2003 letters from the FDIC to Senate and House representatives discussed the importance of controls and prudential factors that the state authority or the FDIC typically imposes to ensure sufficient autonomy and insulation of the bank from its parent.
- A May 2003 speech from the FDIC Chairman regarding ILCs before the Conference of State Bank Supervisors discussed significant restrictions on new ILCs before they receive deposit insurance and mandated safeguards such as onsite management, independent boards of directors, and strict guidelines to ensure arms-length transactions with the parent and other affiliates.
- A June 2004 DSC *Supervisory Insights* article discussed prudential conditions that may be imposed when approving deposit insurance applications for institutions that will be owned by or significantly involved in transactions with commercial or financial companies. The article also noted that the state authority, the FDIC, or both, typically impose certain controls to guarantee sufficient autonomy and insulate the bank from its parent.
- A September 2005 United States Government Accountability Office (GAO) report⁶ included reference to the FDIC's position that the Corporation could adequately protect an ILC from risks arising from being in a holding company without adopting a consolidated supervision approach by, among other things, imposing requirements on an ILC holding company in connection with an application for deposit insurance, as a condition of insuring the ILC.

During our evaluation, we received comments from FDIC officials that were not always consistent with the FDIC's historical position on conditions. We concluded that clarifying policy or guidance addressing the purpose and importance of conditions is needed.

Standard and Nonstandard Conditions: We determined that the FDIC routinely imposed standard and nonstandard conditions, including conditions associated with business plans, as shown in Table 4 on the next page.

⁶ *Industrial Loan Corporations – Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority* (GAO-05-621, September 2005).

Table 4: Standard and Nonstandard Conditions Imposed for the 18 Orders Reviewed

Standard Conditions Pursuant to Regulation (Section 303.2(dd))	Number of Times Condition Imposed
▪ State Approval Obtained	17
▪ Time Limit for Deposit Insurance to Become Effective (1 Year)	18
▪ Conditional Commitment and Interim Developments	18
▪ Merger Transaction: Consummation Period	0
Standard Conditions Pursuant to Delegated Authority^a	
▪ Beginning Paid-In Capital Funds	18
▪ Maintenance of an 8 Percent Tier 1 Leverage Capital Ratio for 3 Years	15 ^b
▪ Approval of Changes in Proposed Management and Ownership of 10 Percent or More of Stock	16
▪ Adoption of an Accrual Accounting System	8
▪ Consummation of Related Transaction	0
▪ Proposed Holding Company Approval to Acquire Control	0
▪ Submission of Proposed Agreements for Permanent Quarters	1
▪ Disclosure of Insider Interest	2
▪ Acceptable Principal Operating Officer(s)	2
▪ Adequate Fidelity Coverage	9
▪ Independent Financial Statement Audit for 3 Years	15
▪ Notification of Proposed Material Changes to the Business Plan for 3 Years	11
▪ Acquisition and Maintenance of Requisite Deposits	1
▪ Any Standard Condition Defined in Section 303.2 (dd)	Presented Above
Examples of Nonstandard Conditions Imposed on 18 ILCs in OIG Review	
▪ No Dividend Distribution Without Prior Approval for 3 Years	6
▪ Ongoing Notification of Proposed Material Changes to the Business Plan	4
▪ Retention of a Majority of Outside Directors	3
▪ Purchase of Affiliate Assets: Compliance with Sections 23A and 23B ^c	2

Source: OIG analysis of DSC policies and procedures and Orders for deposit insurance.

^a These conditions also include a condition that is identical to the State Approval Obtained condition listed under the Standard Conditions Pursuant to Regulation.

^b The Order for one of the remaining three ILCs contained a nonstandard condition for capital maintenance of greater than 8 percent. The business plan for one of the three ILCs reflects capital maintenance in excess of 12 percent for the first 3 years of operations. In addition, the Chartering State Authority imposed capital maintenance conditions of greater than 8 percent for the three ILCs.

^c Sections 23A and 23B of the Federal Reserve Act govern transactions between banks and their affiliates. Section 23A regulates loans to and investments in affiliates of an insured bank by restricting the amount of such loans and investments and by requiring that the loans meet certain standards as to collateral. Section 23B requires that the terms of affiliate transactions be comparable to terms of similar non-affiliate transactions. Section 23B also imposes restrictions on the extent to which a bank may, as a fiduciary, purchase securities and other assets from an affiliate; on the purchase of securities where an affiliate is the principal underwriter; and on the agreement to and advertising of a bank's responsibility for the obligations of its affiliates.

The FDIC can employ a range of enforcement actions, progressing to termination of insurance, in the event that an ILC violates a condition of deposit insurance. Specifically, under the FDI Act, the FDIC can initiate an insurance termination proceeding after a determination by the FDIC that the institution, its directors, or trustees have violated an applicable legal requirement, a condition imposed in connection with an application by the depository institution, or a written agreement between the institution and the FDIC.

We confirmed with the FDIC's Legal Division and DSC officials that the FDIC could take enforcement action for a violation of a condition associated with the granting of deposit insurance, solely on the basis of that condition, regardless of whether a safety and soundness risk was identified. Legal Division and DSC officials cited various subsections of Section 8 of the FDI Act that list "violation of a condition" as one of the predicates for pursuit of enforcement action. No additional findings are required to justify enforcement action, and the FDIC can pursue a violation of a condition without consideration of its safety and soundness or other consequences. According to the Legal Division and DSC officials, the Corporation would expect to prevail in an enforcement action based upon a willful violation of a deposit insurance condition without consideration of any safety and soundness consequences.

Imposing Conditions on the Parent Company: Most of the conditions presented in Table 4 were imposed on the ILCs. However, the FDIC has stated that it can use its authority to approve applications for deposit insurance as a means of requiring an ILC holding company to adopt commitments, operations, and procedures that enhance the safety and soundness of the ILC. In this regard, DSC guidance on prudential conditions notes that applicants should be made aware that "...in addition to nonstandard conditions, liquidity and/or capital maintenance agreements with proposed institutions' parent companies may be necessary in certain circumstances."

GAO's September 2005 report (GAO-05-621) states that, according to FDIC officials, the approval of insurance could be conditioned upon the holding company's (parent company) adhering to prescribed capital levels, adopting a capital maintenance plan for the ILC, and/or other measures such as submitting reports about affiliates to the FDIC. However, according to the GAO report, FDIC officials were unable to provide specific cases in which the FDIC had imposed conditions on an application for insurance that required the holding company to provide specific reports of operations, financial condition, and systems of monitoring risk at the holding company and affiliates.

Our review of 18 ILC Orders for deposit insurance identified two notable conditions⁷ that the FDIC had imposed on ILCs and their parent companies.

- For one ILC, the FDIC imposed a condition requiring that, prior to the effective date of insurance, the ILC's parent and the proposed ILC enter into a Capital Maintenance and Liquidity Agreement (CMLA) acceptable to the FDIC. According to DSC, a CMLA is a

⁷ We also noted that the deposit insurance Orders for three ILCs (UBS Bank USA, Toyota Financial Savings Bank, and Volkswagen Bank USA) required the parent company to maintain in the United States a designated agent to accept service on the parent's behalf, including service of any legal process. The UBS Order also required the parent to consent and submit to United States jurisdiction relating to the administration and enforcement of any banking law.

non-public and situation-specific agreement that ensures a parent company will maintain the capital and liquidity of its subsidiary bank (the ILC). The FDIC, the financial institution, and the parent company are parties to a CMLA.

- For another ILC, the FDIC imposed a condition requiring the parent company to provide the FDIC with a binding written commitment permitting examination of any affiliate of the bank to the extent to which the FDIC determines necessary to disclose fully: (1) the relationship between the bank and any such affiliate and (2) the effect of such relationship on the bank.

GAO's report highlighted limitations in the FDIC's authority to supervise ILC parents and affiliates compared to consolidated supervisors of bank and thrift holding companies. Also, GAO concluded that those limitations are most significant with respect to existing ILC holding companies that are not subject to conditions or written agreements made in connection with the ILC's application for insurance and whose ILCs are not currently financially troubled or exposed to risks from relationships with their affiliates.

Time-Specific and Ongoing Conditions Associated with Business Plans: The FDIC can monitor proposed changes to an ILC's line of business by imposing conditions. The FDIC's standard business plan condition expires after the first 3 years of an institution's operations, referred to as the *de novo* period. The FDIC can also impose nonstandard, ongoing conditions that require the institution to notify or obtain the FDIC's approval of future business plan changes beyond the 3-year period. Our review of the 18 ILC Orders showed that the FDIC imposed standard (3-year) conditions associated with business plans for 11 ILCs and imposed similar ongoing conditions related to business plans for 4 ILCs. The FDIC did not impose conditions associated with business plans for three ILCs in our sample. DSC officials noted that these three Orders pre-date the FDIC's requirement for a business plan condition.

We confirmed that the Corporation could pursue enforcement actions should an ILC fail to notify the FDIC before changing its business plan, based solely on the violation of such a condition. FDIC officials indicated, however, that it is improbable that an ILC would take such a course of action. Instead, based on the FDIC's experience, the ILC would discuss the proposed business plan with the FDIC and obtain the FDIC's non-objection before implementing the business plan change.

The FDIC evaluates proposed business plan changes to ensure the change does not present a safety and soundness risk. The FDIC can deny an ILC's request for a business plan change as long as there is a reasonable basis for challenging the change. FDIC officials stated that a reasonable basis would include a safety and soundness issue or a violation of law or regulation. FDIC officials noted that there generally has to be a reasonable basis for the Corporation to deny a proposed business plan change, otherwise the Corporation could be viewed as being arbitrary and capricious, and the bank could challenge the FDIC's decision in a court of law.

We confirmed with FDIC Legal Division officials that the wording of conditions associated with business plans dictates the level of influence that the FDIC may exercise in reviewing and approving business plan changes. The FDIC's standard business plan condition follows:

That the institution shall operate within the parameters of the business plan submitted to the FDIC. During the first three years of operations, the bank shall notify the Regional Director and its primary Federal regulator, of any proposed major deviation or material change from the submitted plan 60 days before consummation of the change.

We noted that most of the ongoing conditions required the ILC to notify the FDIC of proposed business plan changes, and one condition required the ILC to notify and seek FDIC approval before making material business plan changes. Table 5 provides examples of ongoing business plan conditions that the FDIC imposed.

Table 5: Examples of Ongoing Conditions Associated with Business Plans

Business Plan Condition Language From Orders of Deposit Insurance
<p><i>One ILC in OIG sample</i></p> <p>The bank shall operate within the parameters of the Business Plan submitted as part of the application for Federal deposit insurance and as updated. On an annual basis, the bank will submit updates to the Business Plan to the Regional Director for acceptance/approval. The Business Plan shall be based on prudent operating policies, shall include current and pro forma financial statements and other relevant exhibits, shall prescribe adequate capital maintenance standards relative to the bank’s risk profile, and shall incorporate reasonable risk limits with respect to adversely classified assets (including non-investment grade bonds), industry and individual issuer concentrations, and other relevant risk factors. The bank shall notify the Regional Director of any proposed major deviations or material change from the business plan 30 days before consummating the change. In addition, the bank shall notify the Regional Director within 15 days if any risk limits specified within the Business Plan are exceeded.</p>
<p><i>Three ILCs in OIG sample</i></p> <p>The bank will operate within the parameters of the business plan submitted as part of the application for Federal deposit insurance, including capital adequacy measures therein. On an annual basis, the bank will submit updates to the business plan to the Regional Director. The bank shall notify the Regional Director of any proposed major deviation or material change from the business plan 60 days before consummation of the change.</p>

Source: OIG review of deposit insurance Orders.

An FDIC Legal Division official noted that if the condition requires prior notice before any material change in the business plan, and such notice is given, the institution can implement a change in its business plan without violating the condition. If, on the other hand, the condition requires prior approval of a change, and such approval is not secured, any implementation of the proposed change would violate the condition.

We suggested to DSC that the FDIC could strengthen its ongoing conditions associated with business plans by explicitly stating, within the condition, the FDIC’s rights to approve ILC changes to business plans. DSC officials noted that, regardless of the wording of a condition, if a business plan change presented a safety and soundness concern, the FDIC would identify that concern during its supervisory activities and could pursue enforcement actions, if necessary, through the examination process. Nevertheless, in our view, explicitly requiring the institution to obtain FDIC approval to major or material business plan changes would be a more proactive and efficient approach as opposed to questioning a business change during a bank examination after the institution has implemented the change.

Prudential Conditions Imposed on ILC Applicants: For the 11 ILCs reviewed, we found 1 instance in which the FDIC imposed a prudential condition on an ILC. DSC issued RDM 2004-011, effective March 12, 2004, which identified prudential (nonstandard) conditions that

might be considered in processing applications that present unique characteristics or involve an institution that is to be owned by or significantly involved in transactions with commercial or financial companies, should the risk characteristics of a given proposal warrant such action.

According to DSC officials, prudential conditions evolved from years of ILC supervision by the FDIC and Utah’s Department of Financial Institutions (DFI). In the early 1990s, the regulators discovered that some ILCs operated with minimal quarters, books, records, and management onsite in Utah. The FDIC and DFI held meetings with ILC industry representatives and developed conditions for state charter and federal deposit insurance Orders to address these concerns.

The FDIC issued RDM 2004-011 with examples of prudential conditions that had been imposed in other deposit insurance Orders to address corporate relationships, management authority and independence, and corporate and operating records. Appendix III presents the examples of prudential conditions referenced in RDM 2004-011 that had been imposed in prior approval actions. Additionally, the FDIC incorporated a discussion of prudential conditions into DSC’s CMP Manual and DSC’s instructions on preparing an ROI. Specifically, the instructions state that in the case of an ILC charter, examiners must be particularly cautious in reviewing management competencies, corporate structures and relationships, and the underlying business plans.

DSC officials told us that, in determining the need to impose prudential conditions in approving deposit insurance applications for ILCs, conditions are derived from the elements of a proposal that raise supervisory concern or otherwise warrant attention. Among the primary considerations for DSC are the nature and scope of the business plan, the corporate structure within which the institution will operate, and the risk inherent in the overall proposal. DSC officials noted that the Corporation imposes conditions on a case-by-case basis as it deems appropriate based on the risks presented by an applicant’s proposal.

We reviewed all (11) ILC Orders for deposit insurance issued since the March 2004 effective date of RDM 2004-011 through October 2005 and noted that the FDIC imposed 1 prudential condition in 1 of the 11 ILC Orders as shown in Table 6 below. Appendix VI lists the other standard and nonstandard conditions imposed on the 11 applicants.

Table 6: Prudential Nonstandard Conditions

Prudential Nonstandard Conditions	Number of Times Imposed
▪ Retention of a Majority of Independent Directors	1
▪ Retention of Independent, Knowledgeable and Experienced Executive Officers	0
▪ Maintenance of a Separate Current Written Business Plan	0
▪ Performance of Bank Operations Independent of Affiliated Entities	0
▪ Maintenance of Separate Accounting and Other Business Records	0
▪ Utilization of Written Contracts to Govern Shared Personnel and Resource Arrangements	0

Source: OIG analysis of Orders for deposit insurance and excerpts from RDM 2004-011.

We also reviewed the Orders for deposit insurance and state orders for the 11 applicants to identify state-imposed conditions and other FDIC-imposed nonstandard conditions that were similar to prudential conditions.

State-Imposed Conditions: For the 11 ILC Orders mentioned above, the state of Utah chartered 8 ILCs, Nevada chartered 2 ILCs, and California chartered 1 ILC. We found that Utah imposed conditions similar to prudential conditions in all eight of its chartered ILCs. Specifically, we identified 6 state conditions that were collectively used 18 times. Although we identified similarities between the Utah conditions and prudential conditions, the state conditions were not as strong or as broad as the FDIC prudential conditions detailed in RDM 2004-011. Nevertheless, the Utah DFI consistently imposed conditions on the ILCs that address the authority and independence of the bank, corporate relationships, and operating records. The results of our review are detailed in Appendix VII.

State conditions provide some level of control, but they are not without limitation in regard to the FDIC's authority or the purpose and timeframe of the conditions. For example, the FDIC does not have the authority to enforce violations of state-imposed conditions. Further, the state could relax or eliminate conditions without the FDIC's approval. Finally, the states and the FDIC impose conditions associated with different processes. States impose conditions associated with the bank charter, whereas the FDIC's prudential conditions are associated with granting deposit insurance.

The applications for two ILCs were filed in Nevada and presented issues related to the ILCs' autonomy from the parent companies. The FDIC considered these issues, but neither the FDIC nor Nevada imposed conditions to address these issues:

- In one case, we found that the Chartering State Authority waived its requirement for key ILC management to be residents of Nevada. However, DSC's San Francisco Regional Office recognized that the applicant's proposal was inconsistent with the region's standards for ILCs regarding (1) board independence, (2) board residency in the chartering state, (3) bank records being maintained in the ILC's main office, and (4) key management residency in the chartering state. The applicant resubmitted its proposal and agreed to provide an independent board with two directors residing in Nevada, relocate bank records to the ILC's main office, and establish residency of three senior officers within a year of approval for deposit insurance. DSC examiners verified the applicant's proposed changes.
- While processing the application for the second Nevada ILC, the Dallas Regional Office recognized that the applicant's proposal did not provide for board members or executive officers of the ILC to reside in Nevada. The Nevada Chartering Authority waived the residency requirement for this ILC. In coordination with RMAS, regional officials determined that there was no need to impose board member or executive officer residency requirements. In addition, RMAS officials determined that the ILC's proposed shared-management structure with its parent did not present undue risk to the ILC. We also noted that the applicant proposed a sharing arrangement of affiliate employees and maintaining the ILC's books and records at the affiliate's location.

FDIC Nonstandard Conditions That Resemble Prudential Conditions: We reviewed all of the FDIC nonstandard conditions imposed on the 11 applicants to identify conditions that resembled prudential conditions illustrated within RDM 2004-011 or that addressed the ILC's independence and separateness from its parent. We identified 8 conditions that were collectively used 13 times in 8 Orders that to some extent addressed the authority and independence of the bank, corporate relationships, and transactions with affiliates. Of the eight conditions, five resembled prudential conditions. The results of our review are detailed in Appendix VIII.

The FDIC's Views on the Need for Conditions: During our evaluation, we interviewed several DSC and Legal Division officials about the importance of, and need for, conditions associated with the granting of deposit insurance. One DSC official indicated that conditions principally provided clarity to applicants and new depository institutions. FDIC Legal Division officials indicated that conditions were legally binding on new institutions and helped to ensure that new institutions comply with the statutory factors. DSC RMAS officials indicated that conditions are principally intended to notify the applicant of the FDIC's operational expectations; however, examinations and offsite monitoring activities are the primary means through which the FDIC ensures the safety and soundness of ILCs.

Several DSC officials questioned the need for conditions on ILCs that are similar to conditions imposed by the Chartering State Authority. DSC officials indicated that such conditions would be duplicative. Legal Division representatives noted that the FDIC and the states impose conditions associated with different processes; FDIC-imposed conditions relate to obtaining deposit insurance, while state-imposed conditions relate to the bank charter. Moreover, the Legal Division confirmed that the FDIC does not have the authority to enforce a state-imposed condition.

One DSC official indicated that the FDIC would generally not impose a condition if a deposit insurance application favorably addressed the statutory factor or area of supervisory concern to which the condition pertained. To illustrate, if an application indicates that the proposed bank will appoint a board of directors composed of individuals who are independent of the parent company, the FDIC may not find it necessary to impose a condition on the bank related to an independent board. In our opinion, it would be prudent to impose a condition in such cases to ensure that the new institution continued to comply with the area of supervisory concern.

The FDIC has historically maintained that imposing conditions associated with the granting of deposit insurance is an effective means to preserve an ILC's autonomy and insulate an ILC from its parent holding company. As discussed earlier, we received comments from DSC and the Legal Division that were not always consistent with the FDIC's historical position on conditions. Accordingly, we concluded that clarifying policy or guidance is needed to communicate the FDIC's views on the purpose for and importance of conditions associated with deposit insurance applications.

Recommendation

We recommend that the Acting Director, DSC:

2. Develop and issue clarifying policy or guidance regarding the need for, and importance of, conditions associated with deposit insurance applications. Such policy or guidance should address:
 - the relative importance of conditions in ensuring the safe and sound operation of financial institutions, including ILCs;
 - policy regarding circumstances wherein conditions should be imposed;
 - definitions of conditions and types of conditions;
 - discussion of the FDIC's ability to enforce violations of condition;
 - DSC's position regarding imposing conditions that are similar in nature to state-imposed conditions; and
 - DSC's position on imposing conditions when an application addresses a supervisory concern.

Obtaining the Applicant's Agreement in Writing to Nonstandard Conditions

The FDIC did not always have evidence in its files that the Corporation had obtained the applicant's agreement in writing to nonstandard conditions included in the deposit insurance Order. The FDIC's delegations of authority relating to deposit insurance applications and the CMP Manual provide that the applicant must agree in writing to any condition imposed upon it other than the standard conditions enumerated in the delegations of authority. In addition, the application for federal deposit insurance includes a statement that the FDIC may impose standard conditions when approving a filing whether or not the applicant has agreed to their inclusion, but the FDIC may also request applicants to agree in writing to nonstandard conditions. If the applicant declines to commit to the nonstandard conditions, the regional office cannot act on the application under delegated authority. The FDIC Board retained the authority to act on applications for which the applicant does not agree in writing to nonstandard conditions.

As shown in Appendix IV, for 4 of the 10 ILC Orders for deposit insurance in our sample that included nonstandard conditions, DSC did not have evidence in its files that the FDIC had obtained the applicant's agreement in writing to all nonstandard conditions that the FDIC imposed. In three of the four cases, the applicant's agreement in writing addressed some, but not all, of the nonstandard conditions.

We provided the results of our review to DSC prior to the issuance of the draft of this report. Following issuance of our draft report, DSC located additional information to partially address some of the exceptions that we originally identified in our draft report. We adjusted the number of exceptions from five to four and reflected DSC's additional information in footnotes included in Appendix IV. DSC officials noted that many of the requested records had been archived and shipped offsite. However, the officials remained confident that the work was completed and documented at the time.

DSC officials also noted that although applicants do not have to agree in writing for conditions to be effective and enforceable, the regional offices must obtain an applicant's agreement to nonstandard conditions in writing in order to exercise delegated authority. The officials added that, based on their experience, such agreements are an effective means to ensure that an applicant understands any nonstandard condition prior to the granting of deposit insurance. We concluded that obtaining the applicant's agreement in writing to nonstandard conditions would help to ensure that the applicant has agreed to those conditions.

Confirming the Applicant's Compliance with Conditions

DSC did not always have evidence in its files that the FDIC had confirmed that the applicant had complied with, or had made arrangements to comply with, all conditions before issuing the deposit insurance Order. The FDIC's transmittal of an Order for deposit insurance contains a requirement for the proposed financial institution to provide the DSC regional office satisfactory evidence of the bank's compliance with, or definite and certain arrangements to comply with, the conditions stated in the Order. DSC furnishes the information provided by the proposed financial institution to the FDIC's Office of the Executive Secretary, which formally informs the proposed financial institution of the effective date of federal deposit insurance. DSC officials told us that before opening for business, a proposed insured ILC must:

- certify that its board of directors has adopted a resolution approving the action of the prospective incorporators in preparing and presenting the company's application for federal deposit insurance;
- submit to the FDIC a copy of the ILC's license or authorization to engage in the business of receiving deposits and copies of properly executed incorporation forms and the ILC's Articles of Incorporation; and
- provide evidence of compliance with, or arrangements to comply with, all conditions in the Order.

Appendix IV illustrates that for 7 of 12 ILC Orders that we reviewed, DSC files did not contain documentation that the ILC had provided DSC with evidence of the ILC's compliance with, or definite and certain arrangements to comply with, all conditions in the Order. Specifically, in two cases, DSC files did not contain documentation of the ILCs' compliance with the conditions in the Orders. In the remaining five cases, DSC files contained documentation addressing the applicant's compliance with some, but not all, of the conditions imposed in the deposit insurance Order. We provided the results of our review to DSC prior to the issuance of the draft of this report. Following issuance of our draft report, DSC located additional information to partially address some of the exceptions that we originally identified in our draft report. We adjusted the number of exceptions from nine to seven and reflected DSC's additional information in footnotes included in Appendix IV. DSC officials noted that many of the requested records had been archived and shipped offsite. However, the officials remained confident that the work had been completed and documented.

For the remaining five ILCs, DSC files contained documentation that the ILCs had submitted in response to the FDIC's request for evidence of compliance with the conditions in the Order. An example of this documentation included a letter to the DSC Regional Director, listing the

conditions and a statement regarding actions taken or planned by the ILC as evidence of compliance with each of the conditions. The letter included as attachments the ILC's board of directors' resolution, the ILC's Articles of Incorporation, Chartering State Authority Certificate of Authorization, proof of capitalization, and commitment letter to maintain Tier 1 capital of at least 8 percent for the first 3 years. Satisfactory evidence of the bank's compliance with, or definite and certain arrangements to comply with, the conditions stated in the Order, provides positive confirmation that the applicant has addressed the FDIC's concerns or requirements for obtaining deposit insurance.

Recommendations

We recommend that the Acting Director, DSC:

3. Emphasize to regional and field officials the need to obtain and document the applicant's written agreement to nonstandard conditions.
4. Emphasize to regional and field officials the need to document evidence that the ILC has complied with all conditions stated in the deposit insurance Order.

Evaluating the Probable Impact of an Applicant's Proposed Business Line on Existing Banks in the Community

The FDIC should clarify its expectations and guidance for examiners' evaluation of the probable impact of an applicant's proposed business line on existing banks and businesses in the community. One of the statutory factors, *Convenience and Needs of the Community to be Served*, discusses the deposit and credit needs of the community to be served and the nature and extent of the opportunity available to the applicant in that location. DSC's guidance for investigating this factor provides that an unbiased conclusion--in connection with ascertaining whether or not the services rendered by existing depository institutions are satisfactory and whether or not such institutions are meeting the legitimate credit needs of the community--requires impartial consideration of the opinions of the organizers of the applicant as well as those of the managers of existing institutions. The guidance also states that it is sometimes necessary to solicit the views of representative business and professional persons in the community, together with those of citizens of modest means. The RM Manual indicates that an assessment of *Convenience and Needs of the Community to be Served* should include:

- (1) the solicited views/opinions of representative business and professional individuals in existing financial institutions as well as other businesses in the community to be served by the applicant, and
- (2) the basis for information presented with respect to the probable impact of the proposed business line on existing financial institutions in the community.

ROIs were available for 11 of the 12 ILCs in our sample.⁸ In those 11 cases, we found that 8 reports identified the views and opinions of business and professional individuals in existing financial institutions and that 1 report contained information regarding the identified views and opinions of individuals in other businesses. Although all 11 ROIs contained information with respect to the probable impact of the ILC on existing financial institutions, the ROIs did not always adequately explain how examiners reached their conclusions or the basis for their conclusions. The FDIC could also better clarify whether the investigation of this statutory factor should include an external focus of the applicant's impact on existing banks and business and external risks to the Deposit Insurance Fund.

Views of Professionals in Existing Banks: The RM Manual provides that examiners should assess the competitive dynamics of the proposed market and how the institution will compete for a market share. Officials of area depository institutions should be contacted during the investigation and given an opportunity to express their opinions on the proposal. Any formal objections to the proposal should be investigated, and comments relative to discussions with the objector(s) should be set forth in the ROI. According to DSC guidance, the probable competitive effects of a new institution proposal should be fully weighed by the examiner.

For the 11 ILCs in our sample for which ROIs were available, we noted the following in regard to obtaining the views of professionals in existing financial institutions:

- In three cases, the examiners interviewed officers of three local ILCs.
- In two cases, the examiners interviewed officers of four local ILCs.
- In one case, the examiner interviewed officers from two ILCs and one non-ILC local bank.
- In one case, the examiner interviewed officers from 13 ILCs.
- In the remaining case, the examiner interviewed two presidents of two Salt Lake City, Utah, ILCs. However, the proposed ILC was seeking a Nevada state charter with an accompanying Las Vegas, Nevada, location.

The ROIs for the remaining three ILCs did not indicate whether examiners conducting the investigations sought the views and opinions of business and professional individuals in existing financial institutions.

Views of Individuals in Non-Banking Businesses: DSC's guidance states that it is important that the examiner not adopt the viewpoint of depository institutions located in the community to the exclusion of other, equally persuasive viewpoints. It is sometimes necessary to solicit the views of representative business and professional persons in the community, together with those of citizens of more modest means. DSC's guidance also provides that the results of canvasses and surveys of local individual or business persons should be set forth in the ROI in order to assist in evaluating support for the proposed institution, the adequacy of present depository institution facilities, whether the legitimate banking needs of the community are being met, whether and to what extent the new facility would be used, and the knowledge these persons have of the "proponents."

⁸ The SOI for one ILC for which an ROI was not available did not indicate that examiners had interviewed representatives from existing banks or businesses.

For the 11 ILCs in our sample for which ROIs were available, we identified one case in which the ROI indicated that the views and opinions of individuals in other businesses had been obtained. Specifically, the applicant retained the services of a professional consultant to conduct six focus group meetings to determine the feasibility of the applicant's business line, not necessarily the impact that the proposed business line may have on other businesses.

Basis for Examiners' ROI Conclusions: Although the 11 ROIs contained information with respect to the probable impact of the proposed institution on existing financial institutions in the community, the ROIs did not always adequately explain the basis for the examiners' conclusions. For example, the ROIs did not always indicate whether examiners' conclusions were based on an independent evaluation of community views or a reliance on the applicant's statements in the deposit insurance application. Appendix IX illustrates the ROI comments related to the probable impact of each proposed ILC's business line on existing financial institutions in the community.

Internal or External Focus of Investigation: The FDIC could do more to clarify its expectations regarding investigations. The RM Manual does not clearly indicate whether an investigation of the impact that an applicant may have on the community should have (1) an internal focus on the applicant's safety and soundness and ability to succeed, (2) an external focus on the impact that a proposed applicant could have on existing banks and businesses, or (3) both an internal and external focus.

DSC guidance states that while the number of depository institutions operating in the city or area to be served is important in determining whether the addition of a new institution may result in an over-banked condition, examiners should also consider possible pro-competitive consequences from the new institution's proposal, such as increased customer services and banking options to area residents. Therefore, it is necessary to furnish complete, factual data with respect to the probable impact of the proposal on existing financial institutions in the community.

DSC case managers in San Francisco and examiners-in-charge in Salt Lake City told us that their focus in the area of competition is directed toward the impact that existing institutions might have on the proposed institution and whether the addition of a new bank in the community could result in an "over-banked" condition and affect the ability of the applicant to be successful.

We discussed the matter of assessing the probable impact of a proposed financial institution on existing banks with FDIC Legal Division representatives who indicated that the deposit insurance investigation should have both an internal and external focus in regard to the applicant's impact on existing institutions. Further, the *Risk Presented to the Insurance Fund* statutory factor states that the FDIC must be assured that the proposed institution does not present an undue risk to the Deposit Insurance Fund. The Legal Division representatives also indicated that they view the impact of a new applicant as being more related to the *Risk Presented to the Insurance Fund* statutory factor rather than the *Convenience and Needs of the Community to be Served* factor. Accordingly, we reviewed the *Risk Presented to the Insurance Fund* section of the ROIs for the 12 ILCs in our sample and found no comments regarding the probable impact of the proposed line of business on existing financial institutions in the

community. However, DSC's guidance more clearly addresses the area of an applicant's impact on existing financial institutions within the *Convenience and Needs of the Community to be Served* statutory factor rather than the *Risk Presented to the Insurance Fund* statutory factor.

In our view, this issue may take on greater significance for larger institutions, including ILCs that mix some amount of banking and commerce activities that could have an impact on existing banking and non-banking businesses and could present external risks to the Deposit Insurance Fund. DSC should (1) emphasize that examiners should be documenting the basis for their conclusions and (2) clarify corporate expectations for examiners' evaluation of an applicant's probable impact on existing banks and businesses and the extent to which such evaluations should have an internal and external focus. Such clarifications would help to ensure that examiners adequately investigate an applicant's proposed impact on the community to be served and consider the internal and external risks that an applicant may pose to the Deposit Insurance Fund.

Recommendation

We recommend that the Acting Director, DSC:

5. Issue guidance to (a) clarify corporate expectations for deposit insurance investigations in reviewing the statutory factors *Convenience and Needs of the Community to be Served* and *Risk Presented to the Insurance Fund* in evaluating the possible impact of an applicant's proposed line of business on existing financial institutions in the community and the Deposit Insurance Fund, and (b) emphasize that examiners should document the basis for their conclusions in the *Convenience and Needs of the Community to be Served* area in the ROI.

THE FDIC'S MONITORING OF ILC BUSINESS OPERATIONS

Following the approval of an ILC deposit insurance application, the FDIC monitors ILC business operations through the FDIC's onsite supervisory examination and offsite supervisory programs.

Onsite Supervisory Efforts

DSC performs onsite monitoring and verifies the status of FDIC-imposed conditions during risk-focused visitations and examinations. In addition, the FDIC enhances onsite supervision through the Large Bank Program and the Dedicated Examiner Program.

Safety and Soundness Examinations: At a minimum, and as discussed in the RM Manual, a full-scope examination is conducted within the first 12 months of financial institution operations. The RM Manual also provides that, for newly-chartered institutions, examiners will conduct limited-scope examinations (visitations) within the first 6 months of operations. However, in November 2005, DSC issued RDM 2005-044, *Revisions to Policies for Limited-Scope Examination and Visitation Requirements*, which eliminated the visitation requirement for newly-insured institutions. Although RDM 2005-044 eliminated the 6-month visitation

requirement, DSC officials in San Francisco told us that 6-month visitations would continue to be required for all newly-chartered institutions, including ILCs, in the San Francisco region.

Subsequent to the first examination and through the third year of operation, at least one examination is to be performed each year. Subsequent to the initial full-scope examination, examinations may be alternated with the state supervisory authority if circumstances permit. Nevertheless, according to DSC officials, examination schedules will be adjusted in those cases warranting more frequent onsite reviews.

As discussed later in this report, DSC examiners are expected to specifically address an ILC's compliance with conditions associated with the granting of deposit insurance and evaluate ILC business plans and any changes in business plans during examinations.

Large State Nonmember Bank Onsite Supervision (Large Bank) Program: The Large Bank Program provides an onsite presence at depository institutions through visitations and targeted reviews throughout the year. DSC implemented the Large Bank Program in 2000 and assigned responsibility to the Regional Directors or their designees to determine which institutions qualified for the program, based on a threshold of banks having total assets of \$10 billion or more. In addition to the size of the bank, DSC also considered the complexity and risk profile in determining the institutions that qualified for the Large Bank Program. In February 2006, DSC updated its risk monitoring procedures for large banks and issued RDM 2006-002, *Large Insured Depository Institution Risk Monitoring Program*.

One of the ILCs in our sample is included in the Large Bank Program and is subject to continuous supervision and oversight. We determined that DSC and Utah examiners conducted three targeted reviews of the ILC for the 2004 and 2005 examination cycles, produced separate reports for the first and second reviews in each cycle, and issued Reports of Examination (ROE) in 2004 and 2005 incorporating the results of the third targeted review. Three targeted reviews are scheduled for this ILC in 2006.

Dedicated Examiner Program: The FDIC established the Dedicated Examiner Program in 2002 to provide the Corporation access to the eight largest insured depository institutions in the United States. The FDIC appointed eight dedicated examiners to monitor operations at these institutions by working closely with the federal financial regulators who are the primary supervisors of those institutions. DSC issued RDM 03-017, *Dedicated Examiner Program Guidelines*, on May 2, 2003. The RDM calls for dedicated examiners to prepare quarterly and annual written analytical reports to include, among other things, an in-depth discussion of major business lines and associated risks.

In 2005, the FDIC added two ILCs to this program based on each ILC's size and complexity and the FDIC's desire to have more continuous onsite supervision at these ILCs. One of the two ILCs was included in our sample. This ILC is also included in the Large Bank Program. We reviewed the case manager's quarterly monitoring report for this ILC which indicated that FDIC representatives held periodic meetings with the Swiss regulatory authority regarding this ILC.

Offsite Monitoring Efforts

The FDIC conducts a variety of offsite activities. Formal offsite monitoring of the ILCs is performed through the FDIC's Large Insured Depository Institutions (LIDI) Program and the Offsite Review Program.

LIDI Program: The FDIC established the LIDI Program to provide analyses of risk profiles of companies with total consolidated assets of \$10 billion or more. In January 2004, DSC issued RDM 2003-060, *Large Insured Depository Institutions (LIDI) Process Redesign*, which expanded the scope of the program to include certain ILCs that did not otherwise meet the existing LIDI Program criteria. Case managers prepare quarterly written reports that document the analysis of the risk profile and supervisory strategies of institutions in the LIDI program. We reviewed case manager files for the five ILCs in our sample that were included in the LIDI Program and determined that quarterly reports had been completed for each ILC.

Offsite Review Program: DSC designed the Offsite Review Program to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. The Statistical CAMELS Offsite Rating system and the Growth Monitoring System are offsite review programs based on statistical models that use Call Report⁹ data to monitor the condition of financial institutions and assist in prioritizing onsite safety and soundness examination efforts. After Call Report data is updated each quarter, an Offsite Review List (ORL) is generated. The CMP Manual requires either case managers or field supervisors to perform Offsite Reviews quarterly for each bank that appears on the ORL. DSC regional management is responsible for implementing procedures to ensure that Offsite Review findings are factored into examination schedules and other supervisory activities. DSC completed offsite review reports for 3 of the 12 ILC applications we reviewed.

Results of OIG Review of FDIC ILC Monitoring Efforts

In our review of 11 of the 12 sampled ILC applications,¹⁰ DSC files and reports generally contained evidence of examiners' and case managers' visitations, examinations, and offsite monitoring of conditions and business plans. Although the FDIC generally followed applicable procedures in providing onsite and offsite monitoring of ILC conditions and operations, the process could be strengthened in relation to addressing an ILC's compliance with conditions in visitation and examination reports. Table 7 on the next page summarizes the results of our review of the FDIC's monitoring of conditions imposed in the Orders for deposit insurance. We discuss the FDIC's monitoring of business plans and the extent to which visitation and examination reports address conditions in the next section of this report entitled, *Monitoring Business Plan Conditions*. Further, Appendix X presents the detailed results of our review of onsite monitoring for the individual ILCs in our sample.

⁹ All national banks, state member banks, and insured state nonmember banks are required to file a quarterly consolidated Call Report. Consolidated Call Reports are a widely used source of financial data regarding a bank's condition and the results of its operations. The information is extensively used by bank regulatory agencies in their daily offsite bank monitoring activities.

¹⁰ The Order for 1 of the 12 ILCs in our sample was approved in August 2005. The 6-month visitation had not yet been completed at the time of our field work.

Table 7: Results of OIG Review of FDIC Monitoring Activities at Sampled ILCs

Monitoring Activities	Number of Cases Where We Saw Evidence of Monitoring
<i>Onsite monitoring</i>	
6-month visitation reports that addressed conditions.	9 of 11
Examination reports that addressed conditions.	
First year of operations	6 of 11
Second year of operations	4 of 7 ^a
Third year of operations	0 of 5 ^b
Large State Nonmember Bank Onsite Supervision (Large Bank) Program	One ILC in program
Dedicated Examiner Program	One ILC in program
<i>Offsite monitoring</i>	
Large Insured Depository Institutions Program	5
Offsite Review Program	3

Source: OIG analysis of field and regional office ILC files.

^a Only seven ILCs in our sample had been in business long enough to require second-year examinations.

^b Only five ILCs in our sample had been in business long enough to require third-year examinations.

Monitoring Business Plan Conditions

DSC files and reports generally contained evidence that the FDIC monitored 3-year and ongoing business plan conditions and evaluated ILC-proposed changes to business plans. As discussed earlier in this report, Orders approving deposit insurance include a business plan condition that requires the institution to notify the FDIC in advance of a material change or significant deviation from the established business plan. In most cases, the condition covers the first 3 years of ILC operations; however, in some cases, the condition will extend beyond 3 years. During the term of the condition and after its expiration, the FDIC monitors an institution’s implementation of the established business plan through onsite and offsite supervisory processes. These processes also enable the FDIC to identify any change in the established plan.

The RM Manual states that, during the course of an examination, examiners should review and evaluate current business plans and any changes to a business plan since the previous examination. The guidance further states that business plans, in most instances, should be in written form, and the depth and detail of written plans may properly vary, depending on the nature, scope, and complexity of the financial institution’s operations. A financial institution’s business plan may also be contained in the institution’s operating and ongoing budget, strategic plan, or profit plan. The RM Manual also requires that examiners (1) determine whether a financial institution has a profit plan or budget for the current and/or the next operating year and (2) evaluate the adequacy of management’s budget and other earnings analysis reports at each examination.

DSC had prepared visitation reports and ROEs for 11 of the 12 ILCs in our sample. Each visitation report and ROE issued during the first 3 years of operations contained comments either on the ILCs’ business plans or on a combination of business plans, budgets, and/or strategic plans. For example, one visitation report stated, “The revised business plan appears

conservative, provides for a number of new management positions to oversee the bank's operations, and projects profitability by the end of the third year of operation, consistent with the original application." One of the ROEs provided information about the ILC's plan to implement a new products initiative that will result in additional risk and added that the bank's strategic planning and budgeting process is strong and that the budget contains financial projections to 5 years with estimated launch dates for future products.

Our review of the 34 visitation reports and ROEs issued on the 11 ILCs disclosed that during the first 3 years of operations:

- 30 of the 34 reports included a discussion of the ILCs' business plans, and 25 of the 30 reports contained comments addressing the business plan submitted with the application for deposit insurance;
- 17 of the 34 reports discussed the ILCs' budgets; and
- 19 of the 34 reports discussed the ILCs' strategic plans.

Additionally, we reviewed the 12 ROEs for the 4 banks in our sample that had operations beyond the *de novo* period. Orders for deposit insurance were issued to the respective ILCs from 1998 through 2000. We found that the ROEs issued after the first 3 years of operations for these four ILCs generally addressed either the ILC's business plan, strategic plan, or budget during all years of the ILC's operation.

Material Changes to Business Plans: DSC case managers told us that requests to materially change a new bank's business plan are submitted by means of a letter notice. As previously discussed, the standard change-in-business-plan condition contained in Orders for deposit insurance requires the financial institution to notify the FDIC of the proposed change 60 days prior to consummation of the change. According to the case managers, the notifications usually contain a narrative description of the proposed change, a description of management's fitness to facilitate the change, and pro forma projections that detail the financial effect of the change. When reviewing a proposed material change in a business plan, FDIC staff uses many of the same analytical tools and assessment standards that are applied to applications for deposit insurance – the prospects that the proposal will be successful, that management has the requisite training and experience to implement the change, and that there is sufficient financial support (capital) for the proposal.

We reviewed ROEs for the nine ILCs for which the FDIC had imposed conditions related to business plans and identified three ILCs that had proposed changes to their business plans.

- One ROE reported that bank management presented to the FDIC proposed revisions to its original business plan. The revisions included accelerating the offering of personal mortgages and personal loans, offering credit cards, and not offering business checking accounts. The FDIC noted its non-objection to the business plan revisions, and the ILC implemented the business plan changes.

- Another ROE explained that the bank had requested and received approval from the FDIC and the Chartering State Authority to add a line of credit for certain depositors and make the line of credit available to existing customers.

DSC officials told us that, to the extent necessary, controlling such business plan changes after the expiration of a related condition is accomplished through a variety of means. While moral suasion remains the primary informal corrective tool, the FDIC may pursue board resolutions or memoranda of understanding, if appropriate. The FDIC also possesses broad enforcement powers under the FDI Act to pursue formal enforcement actions, including cease and desist orders, as circumstances warrant. However, the proposed business plan change has to present a safety and soundness risk for the FDIC to take an enforcement action against a business plan change.

Addressing Conditions in Visitation Reports and Reports of Examination

DSC did not always include the examiners' assessment of the ILC's compliance with time-specific and ongoing conditions in examiner visitation reports and ROEs. DSC's policies require this assessment for examinations but not specifically for visitations. Regardless, this information can be useful to case managers in their decision-making efforts to determine whether an institution has complied with conditions imposed in the Order for deposit insurance. In that regard, case managers are responsible for determining that all conditions contained in the Order granting deposit insurance have been met and that field examiners monitor the institution's ongoing compliance with conditions through safety and soundness visitations and examinations. DSC guidance provides that examiners include in the ROE an assessment of actions taken by the ILC to address the conditions.

As a general rule, Orders for deposit insurance include some combination of time-specific and ongoing conditions. Time-specific conditions are primarily focused on organizational matters that must be achieved before the bank is insured. Ongoing conditions may be subject to a defined period of time that varies, depending upon the facts and circumstances of the underlying proposal. The DSC regional or area offices are responsible for verifying compliance with time-specific conditions prior to the financial institution's opening. Compliance with ongoing conditions is primarily evaluated during onsite supervisory activities, including visitations and examinations for the term the condition remains in force. Newly-chartered and insured institutions are subjected to a more frequent regimen of onsite examinations or other supervisory activities during the first 3 years of operation.

The RM Manual includes ROE instructions for addressing conditions and calls for a separate ROE page entitled, "*Compliance with Ongoing Conditions*" for *ORDERs Granting Approval for Deposit Insurance*. The instructions state that this page will be structured to include the administrative action (condition) verbatim for the first examination, the examiner's assessment for each condition, and the steps taken by the financial institution to comply with the condition. The instructions stipulate that the examiner's assessment be documented in a factual manner without a statement of opinion about the institution's compliance with the condition(s).

At subsequent examinations, provisions may be paraphrased or summarized, and the examiner is instructed to address only those points of the action that the institution had not complied with at the previous examination, requirements of a continuing nature, and those for which the time limits had not previously expired. When all provisions have been satisfied and the only remaining provisions are those of a continuing nature (no expiration date), remarks may be limited to a short paragraph on the continuing requirements of the action.

We reviewed Orders for the 12 ILCs in our sample to determine the number of time-specific conditions and ongoing conditions that examiners should review during visitations or first-, second-, and third-year examinations as provided in DSC’s ROE instructions. Table 8 shows the results for the 12 ILCs.

Table 8: Time-Specific and Ongoing Conditions for the 12 ILCs in Our Sample

Industrial Loan Company	Total Number of Time-Specific Conditions	Total Number of Ongoing Conditions	Total Number of Conditions
Pitney Bowes Bank, Inc.	6	1	7
Wright Express Financial Services	5	1	6
BMW Bank of North America	7	2	9
First Electronic Bank	6	3	9
Volkswagen Bank USA	5	5	10
Exante Bank	5	4	9
UBS Bank USA	8	6	14
Goldman Sachs Bank USA	6	5	11
Beal Savings Bank	8	3	11
Toyota Financial Savings Bank	9	6	15
Target Bank	6	5	11
Lehman Brothers Commercial Bank	7	2	9
Total	78	43	121

Source: OIG analysis of Orders for deposit insurance.

Based on DSC’s RM Manual instructions, the first-year ROE should address each of the time-specific conditions identified for the above ILCs. The ongoing conditions should be addressed in the first-, second-, and third-year ROEs. Table 9 on the next page presents the results of our review, and Appendix X presents additional information by ILC.

Table 9: Results of OIG Review of ILC Visitation and Examination Reports

Visitation or Examination Report	Report Specifically Addressed Each Condition	Report Addressed One or Two Conditions	Report Did Not Address Specific Conditions	Totals
Six-month Visitation (Applicable for 11 ILCs in our sample)	2	7	2	11
1 st Year Report of Examination (Applicable for 11 ILCs in our sample)	4	2	5	11
2 nd Year Report of Examination (Applicable for seven ILCs in our sample)	1	3	3	7
3 rd Year Report of Examination (Applicable for five ILCs in our sample)	0	0	5	5

Source: OIG analysis of visitation reports, ROEs, and Orders for deposit insurance.

As shown, visitation reports and ROEs did not always document the status of conditions, as required by the RM Manual. Accordingly, we concluded that DSC could improve reporting on the status of conditions during the 6-month visitation and the first-, second-, and third-year examinations. Without a clear and specific assessment in visitation reports and ROEs that individual conditions continue to be met, case managers may not have the information that they need to assess an ILC's ongoing compliance with conditions associated with deposit insurance.

Recommendation

We recommend that the Acting Director, DSC:

6. Emphasize that examiners should address in 6-month visitation reports and ROEs for the first-, second-, and third-year examinations, each condition in the Order granting deposit insurance and the status of each condition to provide case managers sufficient information to determine an ILC's adherence to the Order granting deposit insurance.

CORPORATION COMMENTS AND OIG EVALUATION

The Acting Director, DSC, provided a written response, dated July 17, 2006, to a draft of this report. DSC's response is presented in its entirety at Appendix XI. DSC concurred with each of the six recommendations. By December 31, 2006 DSC agreed to:

- issue instructions requiring the documentation of pre-filing meetings and inclusion of the results of those meetings in the application materials submitted to examiners responsible for conducting field investigations of deposit insurance applications;
- emphasize the need to obtain and document the applicant's agreement, in writing, to nonstandard conditions;
- clarify DSC expectations for regional and field officials to document evidence that the ILC has complied with all conditions stated in the deposit insurance Order; and

- re-emphasize and clarify how examiners should address conditions in deposit insurance approval Orders and the status of conditions in visitation reports and ROEs.

By June 30, 2007, DSC agreed to:

- review DSC policies and guidance regarding the need for, and importance of, conditions associated with deposit insurance applications and develop clarifying guidance where needed to address the recommendation; and
- clarify corporate expectations for reviewing the statutory factors *Convenience and Needs of the Community to be Served* and *Risk Presented to the Insurance Fund* in deposit insurance investigations and emphasize that examiners should document the basis for their conclusions in the *Convenience and Needs of the Community to be Served* area in the ROI.

DSC's planned actions are responsive to the recommendations, and we consider all recommendations resolved. However, these recommendations will remain open until we have determined that agreed-to corrective actions have been completed and are effective. Appendix XII presents a summary of DSC's responses to our recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to evaluate the FDIC's process for (1) reviewing, investigating, and approving ILC applications for deposit insurance and (2) monitoring business operations to ensure adherence to conditions imposed on ILCs.

Our approach was to address the objective by posing to the FDIC a series of questions related to the manner in which the Corporation reviews, investigates, and approves ILC deposit insurance applications and the extent to which the Corporation oversees ILC operations to ensure that conditions are being met and business plans are being followed. Additionally, we developed application-related statistics on the universe of ILCs and reviewed a sample of 12 ILC applications to evaluate the extent to which the FDIC imposes conditions, approves business plans, and monitors ILC operations.

We performed our evaluation from December 2005 through May 2006 in accordance with generally accepted government auditing standards. We performed field work in DSC's Washington Office; the San Francisco, Dallas, and Kansas City Regional Offices; and the Salt Lake City and Phoenix Field Offices. In addition, we performed field work in the Legal Division.

To accomplish our objective, we performed the following:

- Reviewed applicable policies, procedures, and guidance related to the deposit insurance application process. Specifically, we reviewed:
 1. *FDIC Statement of Policy on Applications for Deposit Insurance*;
 2. *Case Manager Procedures Manual, Applications Overview* (Section 20) and *Federal Deposit Insurance* (Section 21);
 3. *Risk Management Manual of Examination Policies, Applications* (Section 12.1) and *Report of Investigation Instructions* (Section 18.1);
 4. Regional Director Memorandum (RDM) 2004-011, *Imposition of Prudential Conditions in Approvals of Applications for Deposit Insurance*;
 5. RDM 2004-012, *Guidance Related to Parallel-Owned Banking Organizations*;
 6. RDM 2005-044, *Revisions to Policies for Limited-Scope Examination and Visitation Requirements*;
 7. RDM 2006-002, *Large Insured Depository Institution Risk Monitoring Program*;
 8. RDM 03-017, *Dedicated Examiner Program Guidelines*; and
 9. RDM 2003-060, *Large Insured Depository Institutions (LIDI) Process Redesign*.
- Obtained and reviewed Virtual Supervisory Information On the Net (ViSION) System reports for historical, application-related information and examinations for the 12 sampled ILC applications.
- Reviewed deposit insurance applications, business plans, and other supplemental documents submitted with the application for the 12 sampled ILCs.

- Reviewed ROIs for 11 of 12 sampled ILCs to determine whether the field examiner conducting the investigation evaluated the applicant against the seven statutory factors and assessed the applicant's proposed business plan.
- Reviewed the SOIs for the 12 sampled ILCs to determine whether the case manager addressed the seven statutory factors in the SOIs.
- Reviewed FDIC Orders and determined the type of conditions (standard, nonstandard, and prudential) imposed on 18 ILCs. The 18 ILCs included the original sample of 12, as well as an additional 6 ILCs selected for review.
- Reviewed visitation reports and ROEs for the 12 sampled banks to determine the extent to which the reports address compliance with the FDIC Orders and include evidence that business plans are monitored.
- Interviewed field examiners to discuss field investigation procedures, including the evaluation of an applicant's proposed business plan.
- Interviewed Washington Office DSC and Legal Division officials as well as regional senior management, case managers, and field examiners to obtain an understanding of the deposit insurance application process and monitoring process, including compliance with deposit insurance Orders.
- Reviewed field, regional, and Washington Office files for the 12 sampled ILCs for documents related to the deposit insurance application process and monitoring activities.

Validity and Reliability of Performance Measures

We reviewed the FDIC's performance measures under the Government Performance and Results Act, the Corporate Performance Objectives, and the FDIC's Annual Performance Plan. We determined that the 2005 Annual Performance Plan did not include an initiative relating to the Corporation's deposit insurance application process. The 2005 Corporate Performance Objectives included an initiative to refine and communicate FDIC strategies for assuring the safe and sound operation of ILCs.

Reliability of Computer-based Data

We used computer-based data and reports from the ViSION system. However, we did not test the reliability of computer-based data extracted from ViSION because these data are not significant to our findings, conclusions, or recommendations.

Management Controls

We gained an understanding of relevant control activities by reviewing the FDIC's policies and procedures for (1) reviewing, investigating, and approving ILC applications for deposit insurance and (2) monitoring business operations to ensure adherence to conditions imposed on

ILCs and their business plans. To gain this understanding, we interviewed officials involved in the deposit insurance application process, including: Washington Office officials, case managers, field examiners, and Legal Division officials. We also reviewed organizational charts, and other OIG audits and evaluations related to ILCs and business plans.

Laws and Regulations

We gained an understanding of certain aspects of the FDI Act related to applications for deposit insurance and seven statutory factors and Part 303 of the FDIC Rules and Regulations. We also reviewed FDIC Delegations of Authority relating to 12 C.F.R. Part 303 – *Notices and Filings, Enforcement Actions, Transfer Agents, and Pledge Agreements* to identify standard conditions for deposit insurance Orders.

Fraud and Illegal Acts

The nature of our evaluation objective did not require that we assess the potential for fraud and illegal acts. However, throughout the evaluation, we were alert to the potential for fraud and illegal acts, and no instances came to our attention.

Summary of Prior Coverage

In September 2004, the FDIC OIG issued Evaluation Report 2004-048 entitled, *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions*. The OIG concluded that ILCs may pose additional risks to the deposit insurance fund by virtue of the fact that these depository institutions' parent holding companies are not always subject to the scope of consolidated supervision, consolidated capital requirements, or enforcement actions imposed on parent organizations subject to the Bank Holding Company Act. Further, the banking organizations that are being created as a result of ILC charter powers allow some mixing of banking and commerce, which is otherwise prohibited for most depository institutions owned by commercial firms. However, DSC had established controls to help mitigate these added risks. Also, during 2004, DSC issued revised guidance regarding deposit insurance applications, safety and soundness examinations, and offsite monitoring with a focus on limited-charter depository institutions, including ILCs. These controls helped to mitigate the additional risks and supervisory challenges presented by ILCs and their non-bank holding company parents.

The report included eight recommendations designed to improve the deposit insurance application, safety and soundness examination, and offsite monitoring processes. The FDIC generally concurred with the recommendations.

TYPES OF CONDITIONS THAT MAY BE IMPOSED

The FDIC uses conditions to impose restrictions and to establish operating parameters and controls for the institution for a set period of time, usually up to the first 3 years of operation or for an indefinite period of time. Table 10 describes the types of conditions that the FDIC may impose when approving deposit insurance applications.

Table 10: Types of Conditions That May Be Imposed on Deposit Insurance Applicants

Type of Condition	Authoritative Source	Time-Specific or Ongoing
Standard Condition	FDIC Rules and Regulations Section 303.2(dd) identifies four standard conditions.*	Time-Specific condition must be achieved before the financial institution is insured.
Other Standard Conditions	FDIC Delegations of Authority Relating to 12 C.F.R. Part 303, outlines 15 other standard conditions that may be imposed. One of the 15 conditions was identical to the “State Approval Obtained” standard condition pursuant to the FDIC Rules and Regulations. These conditions are illustrated in the subsection of this report entitled, <i>Standard and Nonstandard Conditions</i> .	May be Time-Specific or Ongoing, depending upon circumstances of the application.
Prudential Nonstandard Conditions	DSC’s Regional Director Memorandum 2004-011, dated March 12, 2004, includes six examples of prudential nonstandard conditions that essentially address the relationship between financial institutions and their parent companies -- See Appendix III. Prudential conditions are further discussed in the subsection of this report entitled, <i>Prudential Conditions on ILC Applicants</i> .	May be Time-Specific or Ongoing, depending upon the circumstances of the application.
Other Nonstandard Conditions	The FDIC may impose conditions on insurance where those conditions are warranted by the statutory factors, pursuant to the FDI Act. Nonstandard conditions must be agreed-to in writing by the applicant. Appendix V of this report illustrates other nonstandard conditions that the FDIC imposed on the 12 ILC applicants we selected for review.	May be Time-Specific or Ongoing, depending upon the circumstances of the application.

Source: OIG review of applicable FDIC guidance.

* Standard conditions pursuant to Section 303.2(dd) of the FDIC Rules and Regulations are: (1) applicant has obtained all necessary and final approvals from the federal or state authority; (2) if transaction does not take effect within a specified period of time, consent shall expire; (3) until conditional commitment of the FDIC becomes effective, the FDIC retains the right to alter, suspend, or withdraw its commitment, if warranted; and (4) in the case of a merger transaction, that the proposed transaction be consummated within 30 calendar days of the Order approving the merger transactions.

The term “standard conditions” refers to conditions that may be imposed as a routine matter in an Order or letter approving a filing, whether or not the applicant has agreed in writing to their inclusion. Standard conditions may include the amount and type of capital required, the need for an annual audit, changes in ownership or management prior to opening, and other conditions relating to the findings on the statutory factors. Under the FDIC’s delegated authority, applicants must provide written agreement with nonstandard conditions imposed upon them. Examples of nonstandard conditions are detailed in the section of this report entitled, *Imposing Conditions Associated with Deposit Insurance Orders*.

PRUDENTIAL CONDITIONS

DSC issued RDM 2004-011 entitled, *Imposition of Prudential Conditions in Approvals of Applications for Deposit Insurance* (RDM 2004-011), dated March 12, 2004, which identified prudential (nonstandard) conditions that should be considered in processing applications that present unique characteristics or involve an institution that is to be owned by or significantly involved in transactions with commercial or financial companies, should the risk characteristics of a given proposal warrant such action.

Table 11 presents the examples referenced in RDM 2004-011 as being among the nonstandard conditions imposed in prior approval actions.

Table 11: FDIC Prudential Conditions in Orders for Deposit Insurance

Nonstandard Prudential Conditions
<ul style="list-style-type: none"> ▪ The organizers will appoint a board of directors, the majority of which will be independent of the bank's parent company and its affiliated entities. The board of directors must possess the knowledge, experience, and capability to carry out the responsibilities of the position in a safe and sound manner and independent of the activities.
<ul style="list-style-type: none"> ▪ The bank will appoint and retain knowledgeable, experienced, and independent executive officers.
<ul style="list-style-type: none"> ▪ The bank will develop and maintain a current written business plan that is adopted by the bank's board of directors, appropriate to the nature and complexity of the activities conducted by the bank, and separate from the business plan of the affiliated entities.
<ul style="list-style-type: none"> ▪ The bank conducts business pursuant to operating policies that are commensurate with the proposed business plan, independent from those of affiliated entities, and adopted by the board of directors of the bank. Further, the board will ensure that executive officers are delegated reasonable authority to implement and enforce the policies independently of the bank's parent and affiliated entities.
<ul style="list-style-type: none"> ▪ The bank will adhere to generally accepted accounting principles, maintain separate accounting and other business records, and ensure that the bank's books and records are maintained under the control and direction of authorized bank officials and are available for review by the FDIC at the bank's main office.
<ul style="list-style-type: none"> ▪ To the extent management, staff, or other personnel or resources are employed by both the bank and the bank's parent company or any affiliated entities, the bank's board of directors will ensure that such arrangements are governed by written contracts giving the bank the authority and control necessary to direct and administer the bank's affairs.

Source: DSC RDM 2004-011.

REVIEW OF KEY ILC APPLICATION PROCESSING STEPS

FDIC’s Deposit Insurance Application Process	Pliney Bowes	Wright Express	BMW	First Electronic	Volkswagen	Exante	UBS	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers
Date Insured (Month/Year)	01/98	06/98	11/99	10/00	01/02	07/03	09/03	07/04	08/04	08/04	09/04	08/05
Holding a pre-filing meeting	✓	✓ ^a	— ^b	— ^b	✓	✓	— ^b	✓	— ^b	✓	✓ ^c	— ^b
Reviewing the application for completeness	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Processing the application at the regional and Washington Office level	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Conducting a field investigation and a review of the proposed business plan	✓	✓	✓	✓	✓	✓	✓	✓	— ^d	✓	✓	✓
Reviewing the report of investigation and preparing the summary of investigation	✓	✓	✓	✓	✓	✓	✓	✓	✓ ^e	✓	✓	✓ ^f
Preparing an Order for deposit insurance containing standard and nonstandard conditions	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Obtaining applicant’s written agreement to nonstandard conditions	N/A	N/A	✓	✓	✓	— ^g	✓	— ^h	— ⁱ	✓	— ^j	✓
Acquiring evidence of applicant’s compliance with, or arrangements to comply with, the conditions in the Order	✓	— ^k	✓	✓	— ^k	— ^k	✓	— ^k	— ^k	✓	— ^k	— ^l

Source: OIG review of ILC deposit insurance application files.

^a There was no documentation of a pre-filing meeting; however, bank correspondence indicated that a pre-filing meeting took place. (DSC’s policies do not require that pre-filing meetings be documented.)

^b There was no documentation of a pre-filing meeting.

^c There was no documentation of a pre-filing meeting; however, the case manager stated that a pre-filing meeting took place.

^d The Regional Director waived the field investigation, and DSC provided an explanation.

^e The SOI was completed based, in part, on the results of a safety and soundness examination.

^f The SOI did not address the statutory factor *Consistency of Corporate Powers*.

^g The applicant’s written agreement did not cover all nonstandard conditions. DSC provided information indicating that the applicant’s agreement to the remaining two nonstandard conditions is included in the business plan submitted with the application.

^h The applicant’s agreement did not cover all nonstandard conditions. DSC provided information indicating Washington Office acknowledgment of the applicant’s agreement with one of the three remaining nonstandard conditions concerning the establishment of stock benefit plans. DSC indicated that the applicant’s business plan states that the ILC did not anticipate paying a dividend during the first 3 years of operations – one of the three remaining nonstandard conditions. The information that DSC provided did not address the third nonstandard condition concerning outside directors.

ⁱ No written agreement was in the files that we reviewed.

^j The applicant’s agreement did not cover all nonstandard conditions.

^k The document we obtained did not address all conditions.

^l No document was in the files that we reviewed.

REVIEW OF CONDITIONS IMPOSED FOR THE 12 SAMPLED ILCS

	Pitney Boves	Wright Express	BMW	First Electronic	Volkswagen	Exante	UBS	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers	No. of Times Applied
Standard Conditions Pursuant to Regulation													
State Approval Obtained	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	12
One-Year Time Limit for Deposit Insurance to Become Effective	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	12
Conditional Commitment and Interim Developments	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	12
Merger Transaction: Consummation Period													0
Standard Conditions Pursuant to Delegated Authority													
Beginning Paid-in Capital Funds	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	12
Maintenance of 8% Tier 1 Leverage Capital Ratio for 3 Years	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		11
Approval of Changes in Proposed Management and Ownership	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	12
Adoption of an Accrual Accounting System			✓	✓			✓		✓	✓			5
Consummation of Related Transaction													0
Proposed Holding Company Approval to Acquire Control													0
Submission of Proposed Agreements for Permanent Quarters										✓			1
Disclosure of Insider Interest									✓	✓			2
Acceptable Principal Operating Officer(s)								✓			✓		2
Adequate Fidelity Coverage			✓	✓			✓		✓	✓			5
Independent Financial Statement Audit for 3 Years			✓	✓		✓	✓	✓	✓	✓	✓	✓	9
Notification of Material Changes to the Business Plan for 3 Years				✓	✓	✓	✓	✓	*	✓	✓	*	7
Acquisition and Maintenance of Requisite Deposits	✓												1

APPENDIX V

	Pliney Boves	Wright Express	BMW	First Electronic	Volkswagen	Exante	UBS	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers	No. of Times Applied	
Prudential Nonstandard Conditions														
Retention of a Majority of Independent Directors	The prudential conditions guidance (RDM 2004-011) had not been issued at the time that these applications were processed.											✓		1
Retention of Independent and Experienced Officers														0
Maintenance of a Separate Current Written Business Plan														0
Performance of Bank Operations Independent of Affiliates														0
Maintain Separate Accounting and Other Business Records														0
Written Contracts for Shared Personnel and Resources														0
Other Nonstandard Conditions														
No Dividend Distribution Without Prior Approval for 3 Years						✓		✓			✓		3	
Ongoing Notification of Material Changes to the Business Plan									✓			✓	2	
Retention of a Majority of Outside Directors						✓		✓				✓	3	
Applicant's Parent Shall Establish a Designated Agent and Consent to be Subject to U.S. Court Jurisdiction on Domestic Banking Issues					✓		✓			✓			3	
No Transactions with Non-U.S. Financial Affiliates Without Prior Approval					✓					✓			2	
Maintain Current Information on Non-U.S. Financial Affiliates					✓					✓			2	
Capital Maintenance and Liquidity Agreement											✓		1	
Establishment of Stock Benefit Plan: Subject to Review and Approval for 3 Years								✓					1	
Establishment of Electronic Information System Program			✓										1	
Purchase of Affiliate Assets: Compliance with 23A/23B												✓	1	
Outsourced Functions to Service Providers Subject to Examinations							✓						1	
Applicant's Parent Shall Provide Binding Commitment Permitting Examination of any Bank Affiliate							✓						1	
Maintain a Risk Control Unit Managed Solely by Bank--Retain Chief Investment Officer							✓						1	

Source: OIG review of ILC deposit insurance Orders.

* ILC is subject to a nonstandard ongoing business plan condition.

REVIEW OF CONDITIONS IMPOSED – EXPANDED SAMPLE FOR ILC INSURANCE ORDERS GRANTED FROM MARCH 2004 TO OCTOBER 2005

	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers	Independence	Allegiance Direct	Lease Corporation	GMAC Automotive	Magnet	Saline Mae	No of Times Applied
Standard Conditions Pursuant to Regulation												
State Approval Obtained	<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	10							
Time Limit for Deposit Insurance to Become Effective (1 Year Expiration on Approval)	<input checked="" type="checkbox"/>	11										
Conditional Commitment and Interim Developments	<input checked="" type="checkbox"/>	11										
Merger Transaction: Consummation Period												0
Standard Conditions Pursuant to Delegated Authority												
Beginning Paid-in Capital Funds	<input checked="" type="checkbox"/>	11										
Maintenance of an 8 Percent Tier 1 Leverage Capital Ratio for 3 Years	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	a	<input checked="" type="checkbox"/>	a	a	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	8
Approval of Changes in Proposed Management and Ownership	<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	9				
Adoption of an Accrual Accounting System		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>					<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	5
State Approval Obtained												0
Consummation of Related Transaction												0
Proposed Holding Company Approval to Acquire Control												0
Submission of Proposed Agreements for Permanent Quarters			<input checked="" type="checkbox"/>									1
Disclosure of Insider Interest		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>									2
Acceptable Principal Operating Officer(s)	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>								2
Adequate Fidelity Coverage		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	6
Independent Financial Statement Audit for 3 Years	<input checked="" type="checkbox"/>	11										

APPENDIX VI

	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers	Independence	Alliance Direct	Lease Corporation	GMAC Automotive	Magnet	Sallie Mae	No of Times Applied
Notification of Proposed Material Changes to the Business Plan for 3 Years	<input checked="" type="checkbox"/>	^b	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	^b	<input checked="" type="checkbox"/>	^b	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	^b	7
Acquisition and Maintenance of Requisite Deposits												0
Prudential Nonstandard Conditions												
Retention of a Majority of Independent Directors				<input checked="" type="checkbox"/>								1
Retention of Independent and Experienced Executive Officers												0
Maintenance of a Separate Current Written Business Plan												0
Performance of Bank Operations Independent of Affiliated Entities												0
Maintenance of Separate Accounting and Other Business Records												0
Utilization of Written Contracts to Govern Shared Personnel and Resource Arrangements												0
Other Nonstandard Conditions												
No Dividend Distribution Without Prior Approval for 3 Years	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>	5
Ongoing Notification of Proposed Material Changes to the Business Plan		<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>				<input checked="" type="checkbox"/>	4
Retention of a Majority of Outside Directors	<input checked="" type="checkbox"/>				<input checked="" type="checkbox"/>							2
Applicant's Parent Shall Establish a Designated Agent and Consent to be Subject to U.S. Court Jurisdiction on Domestic Banking Issues			<input checked="" type="checkbox"/>									1
No Transactions with Non-U.S. Financial Affiliates Without Prior Approval			<input checked="" type="checkbox"/>									1
Maintain Current Information on Non-U.S. Financial Affiliates			<input checked="" type="checkbox"/>									1
Capital Maintenance and Liquidity Agreement				<input checked="" type="checkbox"/>								1
Establishment of Stock Benefit Plan: Subject to Review and Approval for 3 Years	<input checked="" type="checkbox"/>											1

APPENDIX VI

	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers	Independence	Alliance Direct	Lease Corporation	GMAC Automotive	Magnet	Sallie Mae	No of Times Applied
Purchase of Affiliate Assets: Compliance with 23A/23B					<input checked="" type="checkbox"/>					<input checked="" type="checkbox"/>		2
Maintenance of a 10 Percent Tier 1 Leverage Capital Ratio for 3 Years								<input checked="" type="checkbox"/>				1
Change in Officers or Directors and Duties and Responsibilities Receives Prior Approval						<input checked="" type="checkbox"/>						1
Develop Method for Allowance for Loan and Lease Loss Adequacy									<input checked="" type="checkbox"/>			1
Majority of Outside Members for Executive Committee									<input checked="" type="checkbox"/>			1
No Entity Holding > 6% or More Control Shall Occupy Specific Positions without Prior Approval										<input checked="" type="checkbox"/>		1
No Entity Holding > 6% or More Shall Directly or Indirectly Control or Influence										<input checked="" type="checkbox"/>		1
No Entity Holding > 6% or More Shall Engage in Transactions with Subject or Its Affiliates										<input checked="" type="checkbox"/>		1
Notification of Change in Performance with Principle Agreements.											<input checked="" type="checkbox"/>	1
Approval of Changes in Management/Ownership (Changed from 10% to 5% of Stock Ownership)						<input checked="" type="checkbox"/>						1
Capital To Be Maintained as "Well Capitalized" for 3 years.									<input checked="" type="checkbox"/>			1

Source: OIG review of ILC deposit insurance Orders.

^a The Order for one of the three ILCs contained a nonstandard condition for capital maintenance of greater than 8 percent. The business plan for one of the three ILCs reflects capital maintenance in excess of 12 percent for the first 3 years of operations. In addition, the Chartering State Authority imposed capital maintenance conditions of greater than 8 percent for the three ILCs.

^b These ILCs were subject to nonstandard ongoing business plan conditions.

CHARTERING STATE AUTHORITY CONDITIONS THAT RESEMBLE FDIC PRUDENTIAL CONDITIONS

We performed a review of all state chartering Orders issued to ILCs from March 2004 through October 2005 to identify those state conditions that could be viewed as a variation of the FDIC's prudential conditions. Table 12 presents the results of our review.

Table 12: Chartering State Authority Conditions and Prudential Conditions

State Conditions With Potential Similarity to Prudential Conditions	Times Applied	Results of Review
<ul style="list-style-type: none"> ▪ Retention of a Majority of Outside-Unaffiliated Directors 	7	<p>The similarity to prudential conditions is strong. These conditions address the board of directors' independence from the applicant's parent and affiliated entities. The conditions used the term "outside-unaffiliated," as opposed to "independent," but the terms generally appear equivalent.</p>
<ul style="list-style-type: none"> ▪ Maintain Certain Executive Officers and Support Staff to Manage the Risks, Maintain Direct Control, and Retain the Applicant's Independence From the Parent Company <ul style="list-style-type: none"> - Maintain Certain Executive Officers and Support Staff Headquartered in [City/State] 	7	<p>The similarity to prudential conditions is strong. These conditions address the applicant's independence and need to provide direct control. However, not all executive officers were included, and the conditions did not address independence from affiliated entities.</p> <p>Also of note, for two of seven conditions reviewed, the state's conditions included a corresponding segment concerning the location of the bank's headquarters.</p>
<ul style="list-style-type: none"> ▪ Neither of Two Venture Capital Funds with Controlling Interest (not exceeding 9.9 percent each) Shall Engage in Any Intercompany Transactions with the Bank or Affiliates 	1	<p>A potential similarity to prudential conditions exists; however, none of the prudential conditions exhibited by DSC discussed related-party transactions. The term "Limiting Transactions" entails the concepts of "Separation of Activities" and "Independence."</p>
<ul style="list-style-type: none"> ▪ Neither of Two Venture Capital Funds with Controlling Interest (not exceeding 9.9 percent each) Shall Occupy Specific Positions ▪ Neither of Two Venture Capital Funds with Controlling Interest (not exceeding 9.9 percent each) Shall Directly or Indirectly Control or Influence 	2	<p>The similarity to prudential conditions is moderate. These conditions indirectly address the independence of directors and management by limiting the control and influence of a certain segment of the applicant's shareholders.</p>
<ul style="list-style-type: none"> ▪ Confirmation That the Proposed Holding Company Does not Have any Controlling Person 	1	<p>The similarity to prudential conditions is remote. While the condition addresses the degree of control maintained within the holding company, the condition does not address the applicant's independence or the separateness from its parent and affiliates.</p>

Source: OIG analysis of State Orders for Charters.

FDIC NONSTANDARD CONDITIONS THAT RESEMBLE PRUDENTIAL CONDITIONS

To provide a balanced perspective, we performed a review of the 19 nonstandard conditions the FDIC imposed in ILC Orders for deposit insurance issued from March 2004 through October 2005 to identify those conditions that showed a similarity to those prudential conditions exhibited in RDM 2004-011. In particular, we identified and reviewed those conditions that either resembled the prudential conditions illustrated in RDM 2004-011 or that addressed the principle of the financial institution’s independence and separateness from its parent. Based on this review, we identified 8 out of 19 conditions that were collectively used 13 times in 8 out of 11 Orders. Table 13 presents the results of our review.

Table 13: Similarity of FDIC Nonstandard Conditions and Prudential Conditions

Other Nonstandard Conditions with Potential Similarity to Prudential Conditions	No. of Times Applied	Results of Review
<ul style="list-style-type: none"> ▪ Retention of a Majority of Outside Directors ▪ Majority of Outside Members for Executive Committee 	3	The similarity to prudential conditions is remote. While these conditions direct an applicant to appoint a certain type of director, the conditions do not address the directors’ independence from the applicant’s parent and affiliated entities.
<ul style="list-style-type: none"> ▪ Ongoing Notification of Proposed Material Changes to the Business Plan 	4	The similarity to prudential conditions is remote. These conditions direct an applicant to submit annual business plans but do not require that the business plans be maintained separately from those of the applicant’s parent and affiliated entities. In addition, the conditions do not require that management be provided reasonable authority and resources to implement and carry out these plans independently of the applicant’s parent and affiliated entities.
<ul style="list-style-type: none"> ▪ Purchase of Affiliate Assets: Compliance with 23A/23B ▪ No Transactions With Non-U.S. Financial Affiliates Without Prior Approval ▪ No Entity Holding > 6% or More Shall Engage in Transactions With Subject or its Affiliates 	4	A potential similarity to prudential conditions exists; however, none of the prudential conditions exhibited by DSC discussed related-party transactions. Limiting transactions and ensuring compliance with Sections 23A and 23B of the Federal Reserve Act involve the concepts of “separation of activities” and “independence.” However, adherence to regulatory requirements would be expected regardless of the condition’s existence.
<ul style="list-style-type: none"> ▪ No Entity Holding > 6% or More Control Shall Occupy Specific Positions Without Prior Approval ▪ No Entity Holding > 6% or More Shall Directly or Indirectly Control or Influence 	2	The similarity to prudential conditions is moderate. These conditions indirectly address the independence of directors and management by limiting the control and influence of the applicant’s shareholders.

Source: OIG Analysis of FDIC Orders for Insurance.

INFORMATION REGARDING THE PROBABLE IMPACT OF APPLICANTS ON EXISTING BANKS

ROIs for 11 of 12 sampled ILCs contained information about the probable impact of the proposed institution on existing financial institutions in the community. We could not determine the basis for some examiners' comments in this regard. Table 14 illustrates the ROI comments related to the probable impact of each ILC's proposed business line on existing financial institutions in the respective community and the basis for the comments.

Table 14: ROI Comments on the Probable Impact of Applicants on Existing Banks

ILC	ROI Comments on the Probable Impact of the Applicant's Proposed Business Line on Other Financial Institutions in the Community	Basis for Comments in the ROI
Lehman Brothers Commercial Bank	The ROI included banker comment summaries, which documented bankers' comments on the probable impact that the applicant's proposed business line might have on their respective financial institutions. However, the examiner did not address the probable impact under any of the statutory factor sections of the ROI.	Interview with local ILC bankers.
Target Bank	"The anticipated volumes for commercial lending products offered by Target Bank are relatively small in relation to the overall market for business lending and should have no material adverse effect on any competing lenders."	We could not determine the basis.
Toyota Financial Savings Bank	"Given the extent of competition and available market share, the Applicant would not adversely impact competition in the delivery of financial services within the market area."	Interview with ILC bankers outside the local community.
Beal Savings Bank	An ROI was not prepared. There was no comment in the Summary of Investigation.	N/A
Goldman Sachs Bank USA	The ROI included banker comment summaries, which documented bankers' comments on the probable impact that the applicant's proposed business line might have on their respective financial institutions. However, the examiner did not address the probable impact under any of the statutory factor sections of the ROI.	Interview with local ILC bankers.
UBS Bank USA	"Applicant's proposed business plan will not have a significant direct impact on competitors offering similar products and services, and if successfully implemented, may attract new customers to the UBS organization and result in an increase in its present nominal share of the market."	We could not determine the basis.
Exante Bank	"Applicant will be doing business on a nationwide basis, and its business and marketing initiative will only indirectly affect the local competition for deposits. ...applicant's proposal and banking solution is unique and will not interfere or harm competition either within the health care or banking industry."	We could not determine the basis.
Volkswagen Bank USA	"Applicant will be doing business on a nationwide basis, and its marketing effort will only indirectly affect the local competition for deposits."	We could not determine the basis.
First Electronic Bank	"Applicant will be doing business on a nationwide basis, and its marketing emphasis and effort will only indirectly impact the local competition for deposits."	Interview with local ILC bankers.
BMW Bank of North America	"The bank will only compete indirectly against local financial institutions and should have a minimal effect on the local market."	Interview with local ILC bankers and one official from a national bank.
Wright Express Financial Services	"The local trade area is served by a number of large, medium, and small commercial banks, credit unions, and federal savings banks. At the local level applicant is not anticipated to have any adverse impact on any of these institutions."	Interview with local ILC bankers.
Pitney Bowes Bank, Inc.	"There have been no critical comments or opposition to the addition of the proposed bank, and it appears that operations will not have a material adverse impact on any existing institutions."	Interview with local ILC bankers.

Source: OIG analysis of ROIs.

RESULTS OF SAMPLE REVIEW OF FDIC ONSITE MONITORING EFFORTS

Activity	Piney Bowes	Wright Express	BMW	First Electronic	Volkswagen	Exante	UBS	Goldman Sachs	Beal Savings	Toyota Financial	Target	Lehman Brothers
Date Insured	1/16/98	6/01/98	11/12/99	10/05/00	1/10/02	7/21/03	9/15/03	7/06/04	8/02/04	8/16/04	9/27/04	8/24/05
Onsite												
Visitation												
6 month	• a	• a	• a	• a	• a	• a	• b	•	• a	✓	✓	
Examination												
1 st Year	•	✓	• a	•	• a	✓	• c	•	✓	✓	•	
2 nd Year	•	— a	— a	•	• a	✓	• c					
3 rd Year	—	—	—	•	— d							

Legend: ✓ = All Conditions Addressed with Statements of Fact • = General Statement That Conditions Were Met — = Conditions Not Addressed

^a The report addressed one or two conditions.

^b This onsite review represents the first of three onsite targeted reviews conducted during the bank's first year of operation.

^c This onsite review represents the amalgamation of a series of onsite targeted reviews conducted during the year. While abbreviated versions of the conditions were listed in the ROE, corresponding statements of fact were not presented.

^d The examination began after the bank's 3rd year anniversary of its date of obtaining insurance. As a result, the Examiner-in-Charge indicated that a review of the Order for insurance was not necessary.

CORPORATION COMMENTS



Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

DATE: Monday, July 17, 2006

TO: Stephen M. Beard
Deputy Assistant Inspector General for Audits

FROM: Sandra L. Thompson Electronically produced version; original signed by Sandra L. Thompson]
Acting Director

CONCUR: John F. Bovenzi Electronically produced version; original signed by John F. Bovenzi]
Deputy to the Chairman and Chief Operating Officer

SUBJECT: Draft Report Entitled, *The FDIC's Industrial Loan Company Deposit Insurance Application Process* (Assignment No. 06-009)

This memorandum represents the Division of Supervision and Consumer Protection's (DSC) response to the draft report entitled, *The FDIC's Industrial Loan Company Deposit Insurance Application Process (Assignment No. 06-009)* ("Draft Report") prepared by the FDIC's Office of Inspector General ("OIG"). The evaluation findings state that "FDIC has implemented a comprehensive process and procedures for reviewing, investigating, and approving deposit insurance applications" and that "[t]he Corporation's monitoring processes provide a reasonable supervisory approach to help ensure that ILCs adhere to the conditions imposed upon them, including those associated with business plans." DSC concurs with the findings and the recommendations in the Draft Report. We agree that issuing clarifying instructions and/or emphasizing certain expectations with respect to our deposit insurance application policies and procedures will further enhance our processes. In DSC's view, the Draft Report's recommendations are not unique to ILCs, but are applicable to all applications for deposit insurance. DSC's proposed actions to address each recommendation, as discussed below, will further strengthen our review and processing procedures for deposit insurance applications for all institutions.

The review and investigation of chartering and deposit insurance applications for new institutions are coordinated between the FDIC and the applicable state chartering agency. The processing of applications is performed in accordance with Sections 5 and 6 of the Federal Deposit Insurance Act (FDI Act), Part 303.20-25 (Deposit Insurance) of the FDIC Rules and Regulations, and the FDIC Statement of Policy on Applications for Deposit Insurance. The FDIC's analysis and processing of applications for deposit insurance are conducted under the same guidelines for all applicants. Applications that present unique characteristics, such as special purpose, foreign owned, nonbank, boutique, and niche type banks are also subject to review by DSC headquarters, which acts on such applications.

The Draft Report contains six recommendations. The recommendations, along with DSC's response to each, are detailed below.

OIG Recommendation

1. “Require that pre-filing meetings be documented and that DSC include the results of the pre-filing meetings in the application material submitted to examiners responsible for conducting field investigations of deposit insurance applications.”

DSC Response

DSC strongly encourages bank organizers to meet with the chartering authority and the FDIC prior to filing an application. When conducted, it is common practice for the DSC participant(s) to document the meeting in a file memorandum. Although encouraged, pre-filing meetings are not a prerequisite to the filing of an application, and some applicants have filed with little, if any, prior communications with the chartering authority or the FDIC. Nevertheless, DSC’s experience has shown that pre-filing meetings are an effective forum for discussing information requirements and identifying potential problems, and that they can facilitate application processing and reduce unnecessary delays.

DSC agrees that it would be beneficial to document the FDIC’s participation in pre-filing meetings and include the results of the meeting in the application material submitted to examiners responsible for conducting field investigation of deposit insurance applications. By year-end 2006, DSC will issue instructions requiring such documentation.

OIG Recommendation

2. “Develop and issue clarifying policy or guidance regarding the need for, and importance of, conditions associated with deposit insurance applications. Such policy or guidance should address:
 - the relative importance of conditions in ensuring the safe and sound operation of financial institutions, including ILCs,
 - policy regarding circumstances wherein conditions should be imposed,
 - definitions of conditions and types of conditions,
 - discussion of the FDIC’s ability to enforce violations of condition,
 - DSC’s position regarding imposing conditions that are similar in nature to state-imposed conditions, and
 - DSC’s position on imposing conditions when an application addresses a supervisory concern.”

DSC Response

The FDIC has the authority to impose conditions in connection with the approval of an application for deposit insurance and to enforce such conditions. While some conditions or limitations may be time-specific, others impose continuing requirements or restrictions and must be satisfied on an ongoing basis, even beyond an institution’s initial years of operation. Conditions that impose ongoing requirements remain in effect so long as the FDIC determines that the condition is necessary to ensure the safe-and-sound operation of the institution.

DSC's guidance with regard to conditions in deposit insurance orders addresses the need to impose, in every case, the conditions relating to the findings on the statutory factors in Section 6 of the FDI Act. Guidance also addresses the use of nonstandard conditions, and situations that may warrant the imposition of prudential conditions. The FDIC evaluates each proposal on a case-by-case basis and imposes the conditions (standard, nonstandard, and prudential) necessary to address the unique characteristics of each business plan. Such flexibility in designing and imposing conditions is essential to the FDIC's deposit insurance approval process. In DSC's experience, the type of charter under which an institution is organized, in and of itself, is not a determinant of risk; however, certain proposals may present unique characteristics warranting the imposition of additional conditions.

By June 30, 2007, DSC will review its policies and guidance regarding the need for, and importance of, conditions associated with deposit insurance applications. Based on the results of the review, we will determine where clarifying guidance should be developed and issued to address the recommendation.

OIG Recommendation

3. "Emphasize to regional and field officials the need to obtain and document the applicant's written agreement to non-standard conditions."

DSC Response

Documentation of an applicant's agreement, in writing, to any condition, other than a standard condition, is required for DSC to act under delegated authority from the FDIC Board of Directors to approve an application for deposit insurance. In situations where applicants do not agree in writing to nonstandard conditions, the FDIC Board will act on applications for deposit insurance.

When processing applications for deposit insurance, FDIC Case Managers must complete an investigation report titled, "Summary of Investigation – Proposed New Bank" (Report) that requires them to verify and respond whether or not the applicant has agreed, in writing, to any condition, other than a standard condition. Additionally, DSC's Case Manager Procedures Manual states, "If nonstandard conditions are appropriate and not agreed to by the applicant, the application must be sent to the Washington Office." DSC is confident, because of its review and approval processes, that the required documentation was obtained in each of the cases cited in the Draft Report. We accept responsibility for these technical exceptions and we will take action to prevent future exceptions.

By year-end 2006, DSC will emphasize the need to obtain and document the applicant's agreement, in writing, to nonstandard conditions.

OIG Recommendation

4. “Emphasize to regional and field officials the need to document evidence that the ILC has complied with all conditions stated in the deposit insurance order.”

DSC Response

DSC procedures require applicants to provide the FDIC with evidence that conditions in deposit insurance orders have been satisfied. Once deposit insurance is approved, the applicant is provided the order, and deposit insurance becomes effective only after the FDIC receives satisfactory evidence of the applicant’s compliance with, or definite and certain arrangements to comply with, the conditions in the order. In practice, evidence of compliance with conditions is often obtained prior to the issuance of the order and in a progressive fashion throughout the deposit insurance application process. In such cases, DSC has historically considered receipt of documentary evidence at any time during the process to satisfy the applicant’s documentation commitment.

The Draft Report also cites instances where documentation received from an applicant did not address all conditions in the order. Orders for deposit insurance typically contain conditions that must be satisfied immediately, as well as conditions that may require an applicant’s future compliance. Examples of such prospective conditions include those requiring prior FDIC approval for future changes in management or ownership, the requirement for an annual audit, notification of a proposed material change to the business plan, etc. Like other conditions, DSC verifies an institution’s compliance with these conditions during onsite visitations or examinations.

DSC concurs that obtaining evidence of a bank’s compliance with, or definite and certain arrangements to comply with, the conditions stated in the order provides positive confirmation that the applicant has addressed or understands the FDIC’s concerns or requirements for obtaining deposit insurance. By year-end 2006, DSC will clarify the documentation expectations in this regard.

OIG Recommendation

5. “Issue guidance to (a) clarify corporate expectations for deposit insurance investigations in reviewing the statutory factors *Convenience and Needs of the Community to be Served* and *Risk to the Fund* in evaluating the possible impact of an applicant’s proposed line of business on existing financial institutions in the community and the Deposit Insurance Fund, (b) emphasize that examiners should document the basis for their conclusions in the *Convenience and Needs of the Community to be Served* area in the Report of Investigation.”

DSC Response

DSC's guidance regarding the consideration and evaluation of the statutory factor *Convenience and Needs of the Community to be Served* requires examiners to assess external factors including the demographic, economic, and competitive factors in the community to be served and to evaluate those factors in relation to the applicant's business plan. As described in the FDIC's Statement of Policy on Deposit Insurance Applications (SOP), "[t]he essential considerations in evaluating this factor are the deposit and credit needs of the community to be served, the nature and extent of the opportunity available to the applicant in that location, and the willingness and ability of the applicant to serve those financial needs." The SOP also discusses the importance of defining the community to be served and services to be offered, and the significance of the proposed bank's efforts to comply with the Community Reinvestment Act.

In assessing the proposed market under the *Convenience and Needs of the Community to be Served* statutory factor, examiners solicit the opinions of the organizers of the applicant, the management of existing institutions, and when necessary, the views of representative business and professional persons and citizens in the community. The results of these surveys are documented in the Report of Investigation.

The assessment of the statutory factor *Risk to the Fund* focuses on an applicant's business plan to determine any unsound activities, practices, or other issues. The SOP states that the factor is intended to be interpreted broadly in order to capture any undue risk to the insurance fund posed by a proposed institution. As such, the factor does not define specific risks to be considered or otherwise limit the range of issues that may be considered in making a supervisory determination. The FDIC may find that, in exceptional cases, any particular element of a proposal may pose undue risk to the insurance fund.

By June 30, 2007, DSC will clarify corporate expectations for reviewing the statutory factors *Convenience and Needs of the Community to be Served* and *Risk to the Fund* in deposit insurance investigations and emphasize that examiners should document the basis for their conclusions in the *Convenience and Needs of the Community to be Served* area in the Report of Investigation.

OIG Recommendation

6. "Emphasize that examiners should address in 6-month visitations and ROEs for the first-, second-, and third-year examinations, each condition in the order granting deposit insurance and the status of each condition to provide case managers sufficient information to determine an ILC's adherence to the order granting deposit insurance."

DSC Response

DSC's Risk Management Manual of Examination Policies (Manual) contains instructions for addressing conditions and calls for a separate page entitled *Compliance with Ongoing Conditions* for orders granting approval for deposit insurance. The instructions discuss the

required format and frequency of documenting an institution's compliance, as well as how examiners should document compliance for provisions of a continuing nature.

By year-end 2006, DSC will re-emphasize and clarify how examiners should address conditions in deposit insurance approval orders and the status of conditions in visitations and in reports of examination.

MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved: ^a Yes or No	Open or Closed ^b
1	DSC will issue instructions requiring documentation of pre-filing meetings and inclusion of the results of those meetings in the application materials submitted to examiners responsible for conducting field investigations of deposit insurance applications.	December 31, 2006	\$0	Yes	Open
2	DSC will review its policies and guidance regarding the need for, and importance of, conditions associated with deposit insurance applications. Based on the results of the review, DSC will determine where clarifying guidance should be developed and issued to address the recommendation.	June 30, 2007	\$0	Yes	Open
3	DSC will emphasize the need to obtain and document the applicant's agreement, in writing, to nonstandard conditions.	December 31, 2006	\$0	Yes	Open
4	DSC will clarify its expectations for regional and field officials to document evidence that the ILC has complied with all conditions stated in the deposit insurance Order.	December 31, 2006	\$0	Yes	Open
5	DSC will clarify corporate expectations for reviewing the statutory factors <i>Convenience and Needs of the Community to be Served</i> and <i>Risk Presented to the Insurance Fund</i> in deposit insurance investigations and emphasize that examiners should document the basis for their conclusions in the <i>Convenience and Needs of the Community to be Served</i> area in the ROI.	June 30, 2007	\$0	Yes	Open

APPENDIX XII

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved:^a Yes or No	Open or Closed^b
6	DSC will re-emphasize and clarify how examiners should address conditions in deposit insurance approval Orders and the status of conditions in visitation reports and ROEs.	December 31, 2006	\$0	Yes	Open

^a Resolved: (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
 (2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
 (3) Management agrees to the OIG monetary benefits, or a different amount, or no (\$0) amount. Monetary benefits are considered resolved as long as management provides an amount.

^b Once the OIG determines that the agreed-upon corrective actions have been completed and are effective, the recommendation can be closed.