

# Charters

## Comptroller's Licensing Manual

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### Introduction

Each organizing group must apply to, and obtain approval from, the Office of the Comptroller of the Currency (OCC) before establishing a national bank. New banks may be chartered for full service or special purpose operations, such as trust banks, credit card banks, bankers' banks, community development (CD) banks, and cash management banks.

This booklet of the *Comptroller's Licensing Manual* (manual) provides organizers and sponsors applying for a national bank charter with OCC policies and procedures used in the charter application process, along with detailed guidance and instructions. It discusses the factors that the OCC considers in deciding a proposed bank's application. It describes the application process, including the prefiling process, filing and review of the application, the decision, and the organization phase. It also provides information about the on-going supervision of a national bank and issues applicable to a special purpose or a narrow focus bank.

A glossary of terms used in the booklet is provided along with a reference section that provides statutory and regulatory cites and other useful materials. Throughout the electronic edition of this booklet at [www.occ.treas.gov](http://www.occ.treas.gov) are hyperlinks to sample documents, such as the Interagency Charter and Federal Deposit Insurance Application (interagency application), and other information that an applicant may find useful.

### Charter Process and Policy

The OCC grants approval of charter applications in two steps: preliminary conditional approval and final approval. Preliminary conditional approval permits the organizers to proceed with organizing the bank. The OCC defines the organization phase as the time period between the preliminary conditional approval and the bank opening (see the Organization Phase discussion in this booklet). During the organization phase, the organizing bank's officers and directors hire management and staff, continue or begin to raise capital, prepare bank premises, and develop policies and procedures that will guide the bank's operations. Receipt of final approval means the bank can open its door and begin to conduct bank business.

Capital must be raised within 12 months of the OCC's preliminary conditional approval or the approval expires. Capital can be raised before preliminary conditional approval but after the establishment of a corporate body (see the Raising Capital discussion in this booklet).

The bank must open within 18 months of the OCC's preliminary conditional approval or the approval expires. A bank can begin the business of banking or engage in fiduciary or other activities after the OCC grants final approval.

The OCC approves proposals to establish national banks that have a reasonable chance of success, will foster healthy competition, and will be operated in a safe and sound manner. OCC approval does not assure that a proposal to establish a national bank is without risk to the organizers or the investors. In reaching its decision, the OCC considers whether the proposed bank:

- Has organizers who are familiar with national banking laws and regulations.
- Has competent management, including the board of directors, that has ability and experience relevant to the type of products and services to be provided and the size and scope of projected risks.
- Has capitalization, access to liquidity, and risk management systems that are sufficient to support the projected volume and type of business.
- Can reasonably be expected to achieve and maintain profitability.
- Will be operated in a safe and sound manner.

Furthermore, the OCC considers a proposed bank's plans for meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank. The OCC also may consider the risk to the Federal Deposit Insurance Fund and whether the proposed bank's corporate powers are consistent with the intent of the Federal Deposit Insurance Act (FDIA) and the National Bank Act.

The OCC encourages each organizing group interested in establishing a national bank to contact the OCC to obtain information about the process and guidance about specific issues that are unique to the group's proposal. The OCC normally requires all of the organizers of a national bank and the proposed chief executive officer (CEO) to attend a pre-filing meeting prior to filing the application.

The organizing group should file an interagency application for deposit insurance with the FDIC when it submits its charter application to the OCC. Each charter application must include accurate statements, fully developed plans, and a determination that the transaction complies with all applicable statutes and regulations.

## Organizing Group's Role and Responsibilities

A strong organizing group generally includes persons with diverse business and financial interests and community involvement. The business plan and other information supplied in the application must demonstrate an organizing group's collective ability to establish and operate a successful bank in the economic and competitive conditions of the market the bank will serve. A poor business plan reflects adversely on the organizing group's ability, and the OCC may deny such applications.

The organizing group must be composed of five or more persons. Normally, all of the organizers serve as the bank's initial board of directors.

The organizers are responsible for:

- Ensuring that the group consists of persons with diverse business and financial interests and community involvement and includes persons with some banking experience.
- Having a personal history that reflects responsibility, honesty, and integrity.
- Exhibiting substantial personal and financial commitment to the proposed bank relative to their individual and collective financial strength.
- Selecting a capable CEO and, early in the organization process, other executive officers who will have the necessary experience to successfully implement the proposed business plan and, thus, enhance the proposed bank's likelihood of success.
- Developing a business plan that:
  - Demonstrates the group's collective ability to establish and operate a successful bank in the economic and competitive conditions of the market to be served.
  - Articulates the risks of the proposed operation and the systems and processes that the bank will use to monitor and control those risks.
- Understanding their role in the successful implementation of the business plan.
- Designing executive officer and other compensation proposals that are consistent with the OCC's guidelines (see the Insider Compensation discussion in this booklet).

The OCC requires each group to appoint a spokesperson or contact person (contact person) who serves as the primary liaison between the OCC and the organizers. The contact person must be a member of the organizing group and a proposed director, unless the proposed bank has a sponsor, such as an existing bank holding company (BHC), in which case a representative of the sponsor may serve in that capacity. The president or CEO of the proposed bank often serves as the contact person.

## Sponsored Organizations

A new bank may be affiliated with another organization, also called a sponsor, rather than choose to operate independently. A sponsor usually is an existing holding company, regardless of whether it is a BHC. If the new bank will be affiliated with an existing BHC (see Glossary), the OCC will consider the BHC to be the sponsor of the new bank. The OCC will look closely at the proposed relationships between the bank and other organization(s) within the holding company to determine whether to permit the affiliation.

The OCC does not consider as a sponsor a new BHC that is established at the same time as a new national bank. Such a BHC generally does not offer significant financial and managerial resources to support the bank's operations. In addition, a new BHC has few activities separate from those of the bank.

## **Sponsor's Role**

When a new bank proposal has a sponsor, the OCC considers primarily the financial and managerial resources of the sponsor and the sponsor's record of performance, rather than the financial and managerial resources of the organizing group. The OCC will review, for consistency and compatibility with the proposed bank's business plan, a sponsor's record of performance, overall philosophy, capital, management, profitability, and plans, such as its strategic plan.

When the sponsor serves as a substantial source of strength, the OCC may approve an application, even in a market in which economic conditions are marginal or competitive conditions are intense. In such cases, the OCC may require the bank to execute a written agreement with its holding company that provides for capital maintenance and liquidity support from the holding company. (See the Special Conditions discussion.) Conversely, the OCC may deny a sponsored new bank application if the condition of the parent company or any affiliate is subject to supervisory concern or otherwise detracts from the application.

With the OCC's prior approval, a sponsor may eliminate certain information from, or provide abbreviated information with, the charter application. However, to reduce the application burden of a proposal involving an insured bank, the OCC encourages the sponsor to file the same interagency application with both the OCC and the FDIC. A BHC, or a company that would become a BHC because of its ownership of a proposed bank, must obtain Federal Reserve Board (FRB) approval to acquire a newly established bank before the OCC will grant final approval.

Sometimes a company, not qualifying as a BHC under federal law, still could be considered a BHC under state law. State law may prohibit certain holding company activities permitted by federal law. Consequently, each sponsor of a proposed bank must demonstrate that its interagency application meets all standards imposed by both federal and state law.

## **Conflicts of Interest**

Conflicts may arise between a sponsored bank and its sponsoring entity in maintaining sufficient corporate separateness between the organizations. This is especially true with special purpose or narrow focus banks. To enhance the corporate separateness of the organizations, the sponsor should evaluate the bank's activities and operations closely and address in the charter application, at a minimum, the following issues:

- The need for bank directors to act primarily in the best interest of the bank rather than the bank's sponsor and to exercise objective judgment in carrying out their duties, independent of undue influence from sponsor management and affiliates. This independence is especially critical when the bank directors are considering:
  - Employment of bank management and employees dedicated to support the bank's operations.



- Maintenance of separate books and records for the bank, the sponsor, and other bank affiliates.
- Implementation of bank board-approved internal and external audit programs, internal controls and risk management policies, and other policies and procedures necessary to ensure safe, sound, and legal bank operations.
- Evaluation of the extent to which the bank itself needs to retain core operations and staff to conduct the bank's business, as opposed to being essentially a "shell operation" (see Glossary).
- Adoption of third-party service provider or vendor management policies that may include affiliated entities functioning as service providers for the bank.

### **Affiliate Transactions**

The discussion that follows addresses only a few of the most common issues that may arise in connection with new bank charters. For further detail on affiliate transactions, see the "Related Organizations" booklet of the *Comptroller's Handbook for National Banks*.

A bank that has a sponsor or other affiliate (see Glossary for definition of affiliate) must be aware of the laws governing affiliate transactions. Sections 23A and 23B of the Federal Reserve Act (FRA), 12 USC 371c and 371c-1, respectively, are designed to protect a bank from transactions with its affiliates that are disadvantageous or abusive to the bank. The FRB implemented sections 23A and 23B of the FRA through Regulation W, 12 CFR 223. The regulation, which became effective April 1, 2003, codifies existing FRB interpretations of sections 23A and 23B and prescribes detailed new requirements, such as rules for valuing the amounts of covered transactions. Thus, newly formed banks and their affiliates must comply with the provisions of this rule as well as the statutes.

Generally, most subsidiaries of banks are not considered to be affiliates of the bank for purposes of sections 23A and 23B as implemented by Regulation W. Subsidiaries that are treated as affiliates include insured depository institutions, financial subsidiaries, and subsidiaries (including uninsured depository institutions) that are also controlled by one or more affiliates of the bank that are not themselves depository institutions. In addition, as previously noted, the OCC and the FRB can determine that an otherwise exempt subsidiary should be treated as an affiliate. (For more information on the treatment of subsidiaries of banks under Regulation W, see the "Investment in Subsidiaries and Equities" booklet.)

Section 23A, as implemented by Regulation W, controls risk to banks by, among other things:

- Limiting "covered transactions" with any single affiliate to no more than 10 percent of the bank's capital and surplus, and aggregate transactions with all affiliates to no more than 20 percent of capital and surplus. Covered transactions include:

- A bank’s extensions of credit to, or guarantees on behalf of, its affiliates or purchases of assets from its affiliates.
  - Investments in securities issued by affiliates.
  - Other specified transactions exposing the bank to risk of abuse by its affiliates.
- Requiring that all transactions between a bank and its affiliates be made on terms consistent with safe and sound banking practices.
  - Prohibiting the purchase of low-quality assets from the bank’s affiliates.
  - Requiring that all “credit transactions” (including, among other things, guarantees and extensions of credit to an affiliate) be secured by a statutorily defined amount of collateral. A full or partial exemption from these restrictions may be available for certain types of transactions. (For example, see section 23A(d) and 12 CFR 223.41 and .42.)

Section 23B of the FRA, as implemented by Regulation W, requires a bank to engage in certain transactions with its nonbank and uninsured bank affiliates only on terms and under circumstances that are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with unaffiliated companies. This requirement generally means that the bank must conduct transactions with these affiliates on an arm’s-length basis. Thus, for example, pricing or transaction valuation must usually reflect fair market value. Section 23B applies this restriction to any covered transaction, as defined by section 23A, and to other specified transactions, such as a bank’s sale of securities or other assets to an affiliate and the payment of money or the furnishing of services to an affiliate. However, section 23B does not prohibit banks from receiving goods or services from affiliates at below market prices. In addition, transactions between a bank and an insured bank affiliate are generally exempt from section 23B. As is the case under section 23A, transactions between a bank and an uninsured bank affiliate are generally not exempt from section 23B.

Regulation W sets forth exemptions from certain restrictions of sections 23A and 23B. Exemptions that may be of importance to sponsors of new banks include the so-called “sister-bank” exemption and the exemption for newly formed banks. The “sister-bank” exemption exempts many “covered transactions” between a bank and an insured bank affiliate from the quantitative limits and collateral requirements of section 23A. Under Regulation W, however, covered transactions between a bank and an affiliated *uninsured* bank, such as a trust company, are not eligible for the sister-bank exemption.

The exemption for newly formed banks allows such banks to purchase assets from an affiliate without regard to the restrictions of either section 23A or 23B. To qualify for these exemptions, the appropriate federal banking agency (the OCC, for national banks) must approve the asset purchase in writing in connection with its review of the formation of the bank. (See sections 223.42(i) and 223.52(a)(1).) If a sponsor plans to rely on these exemptions, it should provide details of any proposed asset purchases in the business plan.

## Parallel-Owned Banking Organizations

In a parallel-owned banking group, at least one United States bank and at least one foreign bank are independently chartered but controlled either directly or indirectly by the same individual, family, or group of individuals who are closely associated in their business dealings or who otherwise act in concert. These persons will be considered members of the establishing party. Processing a charter application that creates a parallel-owned banking organization generally is more complex and time consuming than processing a typical charter application. This processing disparity reflects the OCC's need to understand the following: How the overall strategy and management of the parallel-owned banking organization will affect the national bank; how the activities of the foreign bank are supervised; how home-country supervisors view the condition and operations of foreign affiliates; and how affiliates might affect the national bank. The preceding matters of supervisory interest add to the concerns addressed in the OCC's standard analysis of the background and financial information of the individual(s) filing the charter application.

Concerns for the national bank that arise from a potential parallel-owned banking organization typically result in expanded application requirements. The degree to which the OCC will expand requirements varies, reflecting the specific structure of the proposed transaction and resulting organization. The OCC may request commitments or representations to facilitate the supervision of parallel-owned banking organizations. (See Appendix A, Parallel-Owned Banking Organizations for specific examples.)

To apply legal restrictions on a bank's transactions with its affiliates within a parallel-owned banking group, the 25 percent control threshold in sections 23A and 23B and Regulation W is relevant. Members of a parallel-owned banking group that are affiliates cannot take advantage of the sister bank exemption because that exemption requires ownership by a holding company.

Because of the complexity of proposals that would establish a parallel-owned banking organization and the case-by-case nature of their processing, potential applicants are strongly encouraged to meet with Licensing staff prior to submitting an application.

## Management and Directors' Banking Experience

The OCC requires all organizing groups and senior management teams to demonstrate sufficient banking experience to operate a national bank successfully. The OCC grants a charter application only to a management team, including both the proposed management and directorate, that it considers strong. Strong management teams are usually characterized by:

- High-caliber executive officers that have the relevant experience necessary to implement the proposed business plan and to exercise corrective action in response to changing internal and external factors.
- Successful business and community leaders, including some with prior banking experience, who effectively oversee the management of the bank's activities in their capacity as directors.

## Directors

Each organizer and proposed director is responsible for understanding the chartering process and the role of a national bank director. Each organizer and proposed director should review this booklet to become familiar with the chartering process.

The affairs of each national banking association must be managed by directors who, initially, are elected by the shareholders at a meeting held before the association is authorized to commence business and, afterward, at meetings to be held at least annually, on a day specified in the bylaws.

Each member must exercise objective judgment in carrying out his or her duties, independent of undue influence from management and any controlling companies.

The board of directors of a national bank provides oversight to and direction of the bank's activities. It may delegate the day-to-day routine of conducting the bank's business to the bank's officers and employees, but directors cannot delegate their responsibilities to ensure that the bank's affairs are conducted in a safe and sound manner. The directorate is responsible for safeguarding the interests of the depositors and shareholders through the lawful, informed, efficient, and able administration of the institution.

The board of directors' primary duty is to select and appoint executive officers who are qualified to administer the bank's affairs effectively and soundly. Selection criteria should include integrity, technical competence, character, and experience in the financial services industry. The board also must dispense with services of officers who prove unable to meet reasonable standards of executive performance.

The board's oversight responsibilities include reviewing, approving, and monitoring adherence to major corporate actions and corporate strategies, business plans, risk policies, and risk tolerances. The board also must review appropriate regulatory and audit reports, and take appropriate action on all matters requiring board attention.

Directors must have sufficient experience, competence, willingness, and ability to be active in overseeing the safety and soundness of the bank's affairs. The OCC developed *The National Bank Director's Toolkit* as a reference to assist national bank directors in understanding their roles and responsibilities. (Appendix B, *Directors' Duties and Responsibilities, Qualifications, and Other Issues*, provides a broader discussion of the duties and responsibilities of directors.)

The OCC will expect the organizing group to recommend a stronger team of executive officers to compensate for a proposed directorate that has limited banking experience or community involvement. The OCC is likely to consider more favorably an organizing group's banking experience if the bank's outside directors (directors who are neither officers nor employees of the bank) have recent experience (see Glossary) as directors or executive officers of a well-run financial institution.

In addition, the OCC may consider the following factors in its evaluation of the group's banking experience:

- The proposed board's collective business expertise.

- The group's efforts to obtain directors with recent banking experience.
- Individual bank circumstances, such as a proposed bank with noncomplex operations located in a rural area, for which experienced directors are not readily available.
- Commitments or representations by the organizing group to obtain director education.
- Individual experiences in highly regulated industries; for example, insurance or stock brokerage.

Director education and orientation are available from a variety of sources, including the proposed bank's management, bank consultants, or seminars or "colleges" for new directors offered by local and national industry associations.

To conclude that a representation or commitment for director education is satisfactory, the OCC will consider if the following are present:

- A specific plan with time frames.
- Initial training prior to the bank opening that focuses on the duties and responsibilities of new bank directors. This training should include the importance of an effective, independent risk-monitoring program to assist the board in its oversight of the bank's risk management system.
- Additional training during the first year of the bank's operations tailored to the directors' needs relative to the bank's proposed business plan.
- Ongoing education about new risks, products, and services.

### **Selection of the CEO**

Selection of a qualified CEO is the organizing group's single most important decision affecting the success of the new bank. The proposed CEO should:

- Be involved actively in developing the proposed business plan, since the CEO must implement the proposed plan successfully once the bank opens.
- Have strong leadership skills with successful experience managing a bank or serving as a bank officer in a similar financial institution in areas relevant to the proposed bank's marketing strategy and needs.
- Possess skills that complement those of the directors and other proposed members of the executive officer team, including extensive experience in bank operations or lending.

Selection of a CEO who the OCC finds unqualified for the position, whose prior banking experience is unsatisfactory, or who otherwise is unacceptable, reflects negatively on the organizers and will result in disapproval or revocation of preliminary conditional approval. Decisions about a proposed CEO are based on a

person's suitability for that position with a specific new bank and are not intended to determine that person's eligibility for other jobs.

Each organizing group must disclose its proposed CEO to the OCC at the time it files the charter application. If the proposed CEO would like to have his or her name withheld from the public until the OCC grants preliminary conditional approval, the organizers should:

- Include a request for confidential treatment with the materials submitted in the charter application.
- Provide support for their request that disclosure would constitute an unwarranted invasion of personal privacy under exemption 6 of the Freedom of Information Act (FOIA) or result in substantial competitive harm to the organizers or the proposed CEO under exemption 4 of FOIA.
- List in the application the criteria that were used in the selection process.
- Provide a detailed description of the person's background, experience, and qualifications in the public portion of the application that is sufficiently specific to permit matching the application information with the person once his or her identity is disclosed.
- Discuss the proposed terms of employment for the CEO, including compensation and benefits.

The organizing group must submit an Interagency Biographical and Financial Report (see the "Background Investigations" booklet) for the CEO. In addition, the group must submit documentation of its investigation of the proposed CEO's background and qualifications (see Appendix A: Management Review Guidelines in the "Background Investigations" booklet).

### **Executive Officers**

The organizers are responsible for hiring and retaining executive officers with skills and qualifications appropriate to the size of the institution, its corporate structure, and the nature, scope, and risk of its activities. The organizers must evaluate each proposed executive officer.

Executive officers will be responsible for managing and supervising the day-to-day activities of the bank. They should be able to identify and manage the material risks associated with the bank's activities and provide appropriate and accurate reports to the board of directors of the bank's condition and risk profile. As such, each proposed executive officer should exhibit strong, relevant experience for the specific position for which he or she is proposed. While the lack of previous experience in a specific position may not disqualify a person for the position, the proposed officer must be able to demonstrate that he or she has the knowledge, skills, and abilities required to execute the duties of the position effectively.

The organizing group should include the following information in its application for each executive officer candidate:

- An Interagency Biographical and Financial Report (see the "Background Investigations" booklet).
- A job description outlining responsibilities for each officer's position.
- A detailed outline of each candidate's banking or other relevant experience.
- An assessment of each candidate's qualifications for the position and his or her ability to implement the business plan (see the Management Review Guidelines in the "Background Investigations" booklet).

The organizers should allow the OCC adequate time to complete its review of each executive officer's qualifications. The organizers must receive a no objection determination on the CEO and on other senior executive officers before opening. They should make no final commitments of employment to any officer prior to the OCC's review.

The OCC will assess the strength of the executive officers by considering:

- The extent and quality of the proposed candidate's experience.
- The candidate's skills for the position, including his or her level of knowledge of the businesses and activities that the candidate will manage, the attendant risks, and appropriate risk management functions.
- The complexity of the proposed bank's business plan.
- The use of information technology in the bank's business plan.

If, after appropriate investigation and consideration of a proposed executive officer, the OCC objects to that person, he or she cannot assume that position in the bank. Objection to a proposed executive officer does not mean that the person may not be suitable for a different position in the same bank or a similar position in another bank. It means only that the OCC does not consider the person acceptable for the particular position for which the organizers have proposed in that new national bank.

After considering the qualifications of all proposed executive officers, the OCC will determine if the overall organizing group is strong.

## Insider Policy

The OCC requires each national bank to adopt a written insider (see Glossary) policy addressing its code of conduct and conflicts of interest. This policy must detail business practices the board of directors deems acceptable. The OCC requires this policy in writing for each bank, regardless of its complexity or the degree of sophistication of its systems.

The board of directors must take the lead in protecting the bank from conflicts of interest. One way a board of directors can fulfill that role is by adopting and enforcing clear insider policies to govern conduct and transactions between the bank and its directors and principal shareholders and their related interests and with its officers and employees.

## Transactions with Insiders

Bank insiders (directors, executive officers and principal shareholders) have positions of responsibility and leadership in the community and must be careful to avoid even the appearance of conflicts of interest. Insiders can do this by making sure that their transactions with the bank reflect the same terms and conditions offered to other bank customers. Transactions involving insiders must show no compromise of the bank's interests.

Any financial or other business arrangement, direct or indirect, flowing from the bank to the organizing group or other insiders must be made on terms that are at market value or comparable standards. The bank may receive preferential treatment from the insider, but the insider may not charge the bank a higher rate or require more favorable terms than those prevalent in the market. Additional restrictions and requirements apply to loans made to executive officers. Banking statutes and regulations also impose a number of reporting and record keeping requirements. [See the "Insider Activities" booklet of the *Comptroller's Handbook for National Bank Examiners* (Comptroller's Handbook).]

The bank must comply with the limitations and prohibitions of 12 USC 375a and 375b, as implemented by the FRB's Regulation O (12 CFR 215) and the OCC's Part 31 (12 CFR 31), whenever it makes a loan or extension of credit to its insiders or their related interests. Under those statutes and regulations, a bank (subject to a number of regulatory and statutory exceptions) may not make a loan to an insider in an amount that exceeds the bank's lending limit (15 percent of the bank's capital and surplus for unsecured loans, and an additional 10 percent for loans secured by readily marketable collateral). In addition, a bank cannot extend preferential loans to insiders. Large loans also require the prior approval of the lending bank's board of directors. Insiders must abstain from discussions about, and voting on, their own loans or those concerning related interests.

## Insider Personal and Financial Commitments

The OCC expects all organizers and directors to exhibit substantial personal and financial commitment to a new national bank. Personal commitment includes contributions of time and expertise to the bank's organization (see Appendix B).

Personal wealth is not a prerequisite to becoming an organizer or director of a national bank. However, purchases of shares of bank stock, individually and in the aggregate, should reflect a financial commitment to the success of the national bank that is reasonable in relation to the individual and collective financial strength of the organizers. Financial commitment includes contributions of initial funding and stock subscriptions relative to each person's individual financial capacity. Further, organizers should act prudently on all financial and other aspects of the proposal.

Organizers should not bill excessive charges to the bank for professional and consulting services or unduly rely upon these fees as a source of income. Normally, the bank should not compensate organizers for marketing or aiding in stock solicitation. Directors of new banks should not be dependent upon bank dividends, fees, or other bank-related compensation to satisfy financial obligations. Directors are often the primary source of additional capital for a bank that is not affiliated with



an established holding company. Accordingly, an organizer who also is proposed as a director should be able to supply capital, or have a realistic plan to enable the bank to obtain capital, if needed.

All insiders, including executive officers, should make substantial personal commitments to the organizing bank. Principal shareholders should demonstrate financial commitment through their stock purchases. Directors and principal shareholders also may provide support for the new bank by moving personal and business banking relationships to the bank that will help the bank achieve success. (See the discussion on Transactions with Insiders.)

## Insider Compensation

Any national bank insider's compensation can include salaries, bonuses, fees, benefits, or other goods and services. For a proposed bank charter, the organizing group should include in its interagency application a description of all forms of insider compensation, including stock-based compensation plans.

Organizers should establish compensation plans that are in the best interest of the bank and commensurate with the services the organizers propose to offer. A new bank may include a stock benefit or compensation plan (stock benefit plan), including stock options, stock warrants, and similar stock-based compensation, in its overall compensation for organizers, directors, and officers, provided that it structures the plans appropriately.

### **Regulatory Review**

The OCC evaluates each proposed bank's total compensation package, including its stock benefit plan (see Appendix C for a discussion of stock benefit plans), to determine if it is reasonable considering each person's contribution of time, expertise, and financial commitment. The OCC assesses the amount and basis of any cash or stock payments an organizer may receive as a return for funds placed at risk or for services rendered. In addition, the OCC considers the number and percentage of additional stock warrants or options that the organizers propose relative to the number of shares the bank will issue at the time it opens. The OCC's conclusions about the acceptability of the proposed insider compensation package have a bearing on the OCC's overall assessment of the charter application.

The OCC also reviews proposed insider compensation plans for each newly organized BHC or non-BHC parent for consistency with the OCC's criteria set forth in this booklet and compliance with applicable laws and regulations. The organizers should provide documentation to support the reasonableness of its compensation package, including the methodology used to value any stock options (such as a stock option pricing model or discounted cash flow analyses and relevant comparable data). The OCC has no preference about which method the organizing group uses for its valuation of stock options.

Generally, a material change to the new bank's overall compensation package after the application is filed is a "significant change," which will require the OCC's prior no objection before the bank may open. In some cases, the organizers develop a stock benefit plan for directors or officers after filing the application. The OCC also would consider this development a "significant change." (See Significant Changes

discussion.)

An established company may have existing compensation plans in which the proposed national bank's management and board may participate. The OCC will review such plans closely. In limited circumstances, the OCC may allow bank management and board management to participate in an existing plan that otherwise would be inconsistent with the general criteria for new bank stock benefit plans. In such cases, the OCC will consider whether the compensation, in combination with other forms of compensation, is reasonable.

The FDIC reviews compensation plans in its assessment of each deposit insurance application. The OCC and the FDIC apply similar standards to their separate evaluations of compensation plans. If the organizers would like the OCC and the FDIC to review proposals that may not conform to the stock benefit plan guidelines provided in this booklet, they should provide information and justification to support a deviation from established policies.

In some circumstances, the exercise of rights granted by a stock benefit plan trigger a filing to the OCC under the Change in Bank Control Act (CBCA) (12 USC 1817(j)) or the OCC's implementing regulation, 12 CFR 5.50. The OCC's review of stock benefit plans in connection with a charter application does not satisfy the prior notice requirements under the CBCA. If an option holder's exercise of rights would trigger the prior notice requirements, the holder must fulfill the CBCA prior notice requirement before exercising the option.

### **Unacceptable Forms of Compensation**

The OCC considers as unacceptable any new bank compensation proposal that allows insiders to:

- Purchase stock at an original issue price lower than that paid by other investors.
- Purchase or acquire a separate class of bank or BHC stock at a price lower than that offered other subscribers or with greater voting rights.
- Receive a cash payment based on the market value of the bank's stock.
- Remove cash from the bank's capital accounts.
- Obtain more than one option or warrant for each share of stock subscribed for Type 1 and Type 2 plans at the time of the bank's opening (see the Primary Types of Insider Stock Benefit Plans discussion in Appendix C).
- Receive stock options or warrants issued to a holder other than the name of the bank insider, such as a partnership, corporate entity, spouse, or other family member.
- Exercise "cashless" stock options, such as stock appreciation rights or phantom shares.

These compensation arrangements cause concerns about the bank's ability to raise

additional capital, allow control without a proportionate financial investment, and make it difficult for other shareholders to remove directors if they manage the bank in an unsafe or unsound manner.

### **Excessive Compensation**

Each national bank should maintain safeguards to prevent the payment of compensation that is excessive or that could lead to material financial loss to the bank. Excessive compensation is an unsafe and unsound practice and is prohibited by regulatory safety and soundness standards. The commitment to pay, or payment of, unacceptable or excessive compensation also reflects negatively on the organizing group's charter proposal.

The OCC considers compensation excessive when amounts paid are unreasonable or disproportionate to the services performed by any person for a national bank. The OCC may request additional information from the organizing group to support the compensation or may require the organizers to change or eliminate the form or amount of compensation before it will authorize the bank to open for business. If excessive compensation is discovered before the bank opens, the OCC will disallow payment of that compensation from bank funds and may preclude the bank from opening.

After the bank opens, if the OCC determines that compensation has become excessive, the board is responsible for taking corrective action and seeking restitution. The "Interagency Guidelines Establishing Standards for Safety and Soundness" address excessive compensation and list the factors the OCC considers to evaluate compensation packages (refer to 12 CFR 30, Appendix A).

### **Prohibited Golden Parachute Payments**

The ability of insured national banks to enter into contracts to pay and to make golden parachute payments to institution-affiliated parties (IAP) is limited when the bank is in "troubled condition" (see Glossary). This limitation is imposed in 12 CFR 359. A "golden parachute payment" generally is considered to be any payment in the nature of compensation to an IAP that is contingent on, or payable on or after, the termination of that party's employment and is received when the bank making the payment is troubled. An IAP is broadly defined and includes directors, officers, and employees, among others. The regulation prohibits a troubled bank from entering a contract to pay a golden parachute payment and from making such a payment, subject to exceptions. A procedure also is set forth under which a bank may request permission to enter a contract to pay or to make what would otherwise be a prohibited payment. In light of these restrictions, banks may wish to include in their employment agreements a provision noting that the bank is not contractually obligated to make any payments that are prohibited under 12 CFR 359.

### **Accounting Considerations and Shareholder Disclosures**

Organizers and boards must assure that each component of a bank's compensation package is accounted for properly and that public and periodic regulatory reports (such as Consolidated Reports of Condition and Income (call reports) and securities filings under Part 16) are accurate. In addition, they should refer to the Internal Revenue Code for guidance about shareholder approval and disclosure. Under Part

16, organizers must disclose and describe fully insider compensation, including stock benefit plans, to all prospective stock subscribers in the registration statement or private placement document, regardless of whether shareholder approval is required for the stock benefit plans.

## Organizers' Business Plan

Organizers of a proposed national bank must submit a business plan that adequately addresses regulatory and policy considerations presented in this booklet and set forth in 12 CFR 5.20(e) and (f)(2). The plan must reflect sound banking principles. The organizing group's business plan, including its financial projections, analysis of risk, and planned risk management systems and controls, is critical to the OCC's decision of whether to grant approval to the group's charter proposal.

### **Business Plan Requirements**

The interagency application includes Business Plan Guidelines that list the components of the plan the OCC requires. The business plan should be an integral part of the management and oversight of a national bank and should establish the bank's goals and objectives. The business plan is a written summary of how the bank will organize its resources to meet its goals and how the financial institution will measure progress.

The business plan should be comprehensive and reflect the institution's organizers' and management's in-depth planning. The plan should cover the greater of three years or the time period until the bank is expected to achieve stable profitability. It should provide detailed proposed actions to accomplish the primary functions of the bank. It should realistically forecast market demand, customer base, competition, and economic conditions. The business plan should contain sufficient information to give realistic assessments of risk related to economic and competitive conditions in the market the bank will serve. Assumptions should be consistent with all other information presented in the application.

The organizing group demonstrates in the business plan its management and planning abilities by assuming reasonable risks and by developing a comprehensive alternative business strategy. The organizers should describe clearly their assessment of risks inherent in the products and services of the bank and the design of related risk management controls and management information systems. (See Risk Assessments and Risk Management discussions in Appendix D.)

The group should integrate an alternative business strategy into its business and strategic plans and bank policies. Through the alternative business strategy, the organizing group demonstrates that it can manage potential scenarios prudently, efficiently, and effectively when the asset or deposit mixes, interest rates, operating expenses, marketing costs, or growth rates differ significantly from the original plan. This alternative plan should include realistic plans for how the board would access additional capital should it be needed. (See Appendix D of this booklet and the "Bank Supervision Process" booklet of the *Comptroller's Handbook*, which includes a thorough discussion of each type of risk.)

Organizers for a bank that will have a special purpose or narrow focus should tailor the contents of their business plan as appropriate. The OCC also expects these

business plans to articulate clearly a comprehensive alternative business strategy should original plans not materialize. (See the Special Purpose and Narrow Focus Proposals section in this booklet.) The organizers should not omit or delete sections of the business plan without prior consultation with OCC staff. In addition to the financial information required by the interagency application and business plan, the OCC requires each application sponsored by a holding company, including a BHC, to provide consolidated financial projections using the interagency format and time periods.

### **Avoiding Potential Problems**

Management and the board should have similar goals for the bank and similar plans about how the goals will be achieved. Management and the board should be committed to the proposed business plan and agree on the amount of risk that the bank is willing to take. They can identify and work out differences of opinion and potential problems before the bank opens through:

- Careful development of policies and procedures for functional areas of the bank, including systems and controls that will be used to manage and control attendant risks.
- Preparation of financial projections.

In addition, organizers should be prepared to handle difficulties in hiring qualified personnel. They also should be able to project and control compensation and overhead expenses and to factor those expenses into their evaluations of capital adequacy.

### **OCC Evaluation of Proposal**

The OCC evaluates the organizing group and its business plan at the same time. The OCC must be able to determine that the bank has a reasonable chance for success, will operate in a safe and sound manner, and will have capital that is adequate to support the proposed risk profile.

An organizing group and its business plan must be stronger in markets where economic conditions are marginal or competition is intense. The OCC's judgment concerning one may affect its evaluation of the other. It may offset deficiencies in one factor by strengths in one or more other factors. However, deficiencies in some factors, such as unrealistic earnings prospects or inadequate risk management systems, will have a negative influence on the OCC's evaluation of other factors, such as capital adequacy. Some deficiencies may be serious enough to result in denial of an application. The OCC considers inadequacies in a business plan to reflect negatively on the organizing group's ability to operate a successful bank.

The OCC assesses how well an organizing group has evaluated each of the nine categories of risks in its preparation of the charter application and how well it integrates risk management into its bank operations. (See Risk Assessments and Risk Management discussions in Appendix D.) The OCC considers safety and soundness issues and compliance with applicable laws and regulations in its evaluation of the business plan. The OCC has adopted interagency safety and soundness standards, which are found in the appendices to 12 CFR 30. These standards cover operations,

management, compensation, and safeguarding of customer information. Additional guidance on prudent risk management practices can be found in the various booklets of the *Comptroller's Handbook*.

The OCC may conditionally approve an application to ensure that appropriate supervisory safeguards are in place when a bank opens for business. Alternatively, the OCC will deny an application if it is not satisfied that the organizers have met these requirements. The OCC generally will not grant final approval for a bank to open unless and until the organizers have addressed adequately all substantive risk management concerns.

## Capital Considerations

### **Organizers' Responsibilities**

The organizers must propose and raise capital for the bank's operations. Throughout the chartering process, the organizers must be aware of the OCC's capital policy and regulatory capital requirements.

The organizing group is responsible for proposing an appropriate level of capital based upon:

- A thorough assessment of the proposed business plan and the risks inherent in that plan.
- Management's skills, experience, and ability relative to those required to execute the plan successfully.
- The degree of competition in the marketplace.
- Prevailing economic conditions in the proposed market.

The organizers also must demonstrate a clear ability to raise additional capital, if needed.

### **Policy and Legal Issues**

Because charter proposals present varying degrees of complexity, the OCC does not mandate a minimum dollar level of capital for national bank charter applications. Instead, consistent with the OCC's philosophy for supervising all national banks on the basis of risk, the OCC evaluates sufficiency of the proposed capital level in light of the risks present.

The OCC expects projected capital for a new bank to remain at or above the "well capitalized" level as defined in 12 CFR 6.4(b)(1) for the first three years of operations and until the bank is expected to achieve stable profitability. These are "minimum capital standards." The OCC may determine that higher amounts of capital from those the organizers proposed are warranted based on local market conditions or the proposed business plan.

Generally, the OCC will require higher levels of capital to support the operations of more complex bank proposals. A complex charter proposal, for example, might

offer a nontraditional or narrow range of products, propose an unproven business strategy resulting in uncertain financial projections, or operate in a highly competitive market. Conversely, a charter application for a community bank that would offer traditional products and services, operate within a small geographic area lacking intense competition, and have a management team implementing a proven business strategy would be noncomplex and, generally, would not require higher capital.

As appropriate, the OCC will focus on the consolidated company risk profile when reviewing a BHC-sponsored charter application. The risk assessment also may include significant affiliated entities when the OCC considers it appropriate.

The FDIC has capital requirements for obtaining federal deposit insurance that are similar to the OCC's requirements. The FDIC requires that initial capital should be sufficient to provide a Tier 1 capital-to-assets leverage ratio of not less than 8 percent throughout the first three years of operations.

### **Key Capital Considerations**

Organizers must address key considerations in supporting the proposed capital level including:

- On-and-off balance-sheet composition, including credit risk, concentration risks, market risks, and risks associated with any nontraditional products, services, or operating characteristics.
- Plans and prospects for growth, including management's past experience in managing growth.
- Stability or volatility of sources of funds.
- Access to capital sources.
- If sponsored by a holding company, the sponsor's track record when implementing plans and confronting emerging risks or needs.

### **Raising Capital**

The organizing group and founders (see Glossary) must lead the bank's efforts to raise capital in the marketplace by raising capital that is sufficient to:

- Pay for all organization costs.
- Enable the bank to compete effectively in the market area.
- Support the proposed bank's business plan until the bank can achieve and sustain profitable operations.
- Address uncertainties in the marketplace.

When the organizing group files its application with the OCC, it should indicate how it plans to raise capital. Prior to soliciting and selling stock, the organizers must accomplish all of the following:

- Submit a completed application including a business plan.
- Receive the OCC's determination that the application is complete, which is based upon the review conducted by Licensing staff using the Charter Application Checklist.
- Receive a declaration from OCC legal staff that the registration statement is "effective", if a registration statement is filed under 12 CFR 16 that includes all the required information. The standard turnaround time between the submission of a registration statement and an effective declaration will generally be within 10 business days.
- Designate an unrelated insured depository institution as escrow agent of the stock subscription funds and ensure there is sufficient liability coverage by either the bank or escrow agent.

Even if the group raises all its capital during the OCC's review of the application, the OCC makes no assurances that it will grant preliminary conditional approval. Material changes may occur during the bank's organization that could require amendments to the bank's disclosures and rescission offers to stock subscribers. An organizing group must complete raising capital within 12 months of the OCC's preliminary conditional approval or the approval expires.

### *Offerings*

All organizing banks issuing securities must comply with 12 CFR 16 by filing a registration statement or by relying on a filing exemption. A national bank seeking to sell or offer its securities must comply with both the applicable federal securities laws, including anti-fraud provisions, and OCC regulations. These requirements apply when organizers capitalize a newly chartered bank, or when shareholders raise additional capital to support the bank's growth.

Organizers should consult with securities counsel in preparing Part 16 filings or refer to guidance and sample forms provided in the regulation. The OCC will not declare the registration statement effective until the organizers have met all requirements. Amended registration statements also must comply with 12 CFR 16.

The sale of holding company stock may require filing documents and registering them with the SEC. Organizers should discuss securities law issues with their legal counsel and appropriate OCC legal staff as part of the application process.

### *Stock Brokers, Underwriters, or Other Consultants*

Some organizing groups rely upon third parties to raise capital. These third parties include brokers, underwriters, consultants, and marketing firms. Engaging third parties may be part of the original business plan or represent a significant change in the original business plan, particularly if the organizing group has trouble raising



capital. When banks raise capital through a third party, the market test (see Glossary) may be a less reliable indicator of market acceptance, especially if a significant portion of the stock is subscribed from outside the local market.

If the organizers use a third party, the charter proposal must still demonstrate that the target market will support the proposed bank, particularly if local stock subscriptions are limited. Local stock subscriptions include subscriptions from organizers who reside in, or otherwise have a meaningful presence in, the target market.

### *Funds Collected by an Organizing Bank*

The amount of funds collected under the terms of a registration statement may exceed the amount proposed. To raise additional capital after the initial offering closes, the organizing directors must authorize additional shares and prepare an amendment to the registration statement or rely on an applicable exemption under 12 CFR 16. Furthermore, the organizing board may wish to authorize more shares than it intends to issue initially to facilitate future capital changes, such as stock sales and stock splits, without holding a shareholders' meeting to amend the articles of association. Once opened, the bank must issue shares in accordance with 12 CFR 5.46 (see the "Capital and Dividends" booklet).

"Capital surplus" generally is created when stock is sold. Capital surplus is required for a bank to pay dividends and may be required for a bank with branches or trust powers. Accordingly, all money invested in the bank must be distributed between the bank's capital and capital surplus accounts consistent with Generally Accepted Accounting Principles (GAAP). Also, consistent with GAAP, direct costs associated with the sale of stock must be deducted from the related proceeds and the net amount recorded in the contributed capital accounts.

### *Body Corporate*

An organizing group may begin to solicit capital after becoming a body corporate, filing a completed application to the OCC, and having a registration statement declared effective by the OCC (see Glossary). After filing the Articles of Association and Organization Certificate, a national bank becomes a body corporate or legal entity as of the date the organizers sign the Organization Certificate and adopt the Articles of Association. After becoming a body corporate, the organizing group elects a board of directors and may begin entering into contracts and performing all necessary actions to form the bank other than engaging in the business of banking.

### **Capital Structure**

Generally national banks have only one class of common stock. National banks may not create classes of common stock with different or no voting rights. Federal banking law provides that common shareholders are entitled to one vote per share in all matters. The law also allows the shareholders to choose whether to provide for cumulative voting when electing the bank's directors by authorizing it in the articles of association. If a bank proposes to issue more than one class of common stock, legal, supervisory, and policy issues must be considered. A bank should consult with the OCC prior to issuing more than one class of common stock.

A national bank may be organized as a Subchapter S corporation. A Subchapter S corporation generally has a limited number of shareholders as determined in 26 USC 1361. However, all members of a family may elect to be treated as one shareholder to determine the total number of shareholders of an S corporation.

### *Preferred Stock*

The OCC has no general prohibition against the inclusion of preferred stock in the initial capital structure of a new national bank. All relevant terms and conditions should be set forth in the application. To be included as Tier 1 capital, the preferred stock must be perpetual and noncumulative.

### *Debt-based Capitalization*

While equity is the most traditional form of capital, the OCC will consider debt-based capitalization of a new bank. However, business and financial plans must demonstrate that the associated debt service requirements are not detrimental to the safety and soundness of the bank.

## Assessment of Community Credit Needs

The organizing group must comply with the Community Reinvestment Act (CRA) by demonstrating in the application its knowledge of and plans for serving the proposed bank's assessment area or areas. The organizing group must evaluate the banking needs of the community, including its consumer, business, nonprofit, and government sectors. (See Appendix E, "Community Reinvestment Act Highlights," for more information about responsibility under CRA, the CRA assessment area, and performance standards. Also, see the "Community Reinvestment Act Examination Procedures" booklet of the *Comptroller's Handbook for Compliance* for an expanded discussion of this topic.)

## Compliance Issues

The OCC also considers compliance with laws and regulations in its review of charter applications. Issues often arise about fair lending statutes, Bank Secrecy Act (BSA) and anti-money laundering provisions, privacy, and advertising. (See Appendix F, "Compliance Highlights," and the *Comptroller's Handbook for Compliance* for expanded discussions of these topics.)

## Electronic Banking (e-banking) Concerns

Novel questions and issues often arise in the application process about the use of the Internet for delivery of banking products and services. The OCC approves proposals to establish national banks that will use an electronic delivery channel when the bank reasonably may be expected to operate successfully and in a safe and sound manner.

The information technology-related risks and controls are similar for the various e-banking channels but may vary from the risks associated with traditional banking operations. Risks associated with liquidity, vendor management, information system security, weblinking, firewalls, encryption, intrusion detection, and e-banking

support services are discussed in the "E-Banking" and "Information Security" booklets of the *FFIEC IT Examination Handbook* series.

A bank's business plan that is heavily reliant upon e-banking may underestimate the marketing and operating expenses necessary to attract and retain new deposits over the Internet. Consequently, this may increase a bank's risk, especially liquidity risk. A bank should discuss in its business plan how it expects to manage such increased liquidity risk. (See the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for a discussion of liquidity risk.) Likewise, excessive reliance on deposits generated by Internet solicitations can raise special concerns. (See Advisory Letter 2001-5, "Brokered and Rate-Sensitive Deposits.")

## Application Process

The OCC encourages organizers to review the OCC's Web site for more detailed information about the application process, including relevant charter policies and procedures. The Web site contains decision statements on previous OCC charter decisions and provides information on the policy matters that the OCC considers prior to making a decision on an application. The Web site also contains opinions and legal interpretations addressing a variety of permissible activities and the manner in which the activities may be established and conducted.

Before filing an application, the OCC encourages each organizing or investor group to contact the director for district licensing at the appropriate OCC district office to discuss its proposal. The OCC encourages groups to submit a draft for OCC staff review if groups desire technical assistance. Each group should include requests for confidential treatment under the FOIA with each submission of materials for which it seeks confidentiality (see "General Policies and Procedures" booklet for further discussion about confidential treatment).

## Exploratory Calls or Meetings

The contact person may call the Licensing staff at the appropriate district office at any time to ask for further information or assistance. As the organizing group develops key ideas, the contact person may request an exploratory conference call or meeting to ask questions, clarify concerns, and become acquainted with the regulatory environment. The district Licensing staff will coordinate an initial conference meeting or call for the contact person and other key people associated with the proposal to discuss issues with appropriate OCC staff.

## Prefiling Meeting

The contact person for the organizing group should contact the OCC's Licensing staff in the appropriate district office to schedule a prefiling meeting when the organizing group is almost ready to file its charter application. Prior to this meeting, the organizers should submit briefing materials to the OCC that include:

- A brief description of the proposal.
- Biographical information on each member of the organizing group.

- Identification of the CEO.
- A summary of insider transactions.
- The proposed amount of capital and subscription method.

The OCC rarely waives the pre-filing meeting for applications that are accorded standard review. The OCC expects all organizers of the proposed new national bank to attend this meeting. When requested, OCC staff members may conduct the pre-filing meeting at an appropriate location proposed by the filer rather than at the OCC office.

At the pre-filing meeting, or in informal discussions, the Licensing staff reviews with the organizing group the OCC's chartering policy and procedures. Licensing staff also discusses supervisory perspectives that may affect the proposal and the requirements for filing a charter application and organizing a national bank. The topics discussed include:

- The attributes of a national bank charter.
- The composition of the board of directors and the banking and business experience of its members.
- The management team and its banking experience.
- Submission requirements, including confidentiality requests.
- The business plan.

FDIC staff also may participate in the pre-filing meeting to discuss pertinent procedures and requirements for obtaining deposit insurance. (See the FDIC's deposit insurance policy statement, available from its Communications Office, Public Information Center, 801 17th Street NW, Washington, DC 20434, or from its Web site at <http://www.fdic.gov>.)

## Filing the Application

After the pre-filing meeting, the organizing group files an interagency application, including a business plan and the appropriate Interagency Biographical and Financial Report on all identified insiders. Each applicant must:

- Prepare accurately and completely the charter application submitted to enable the OCC to reach an informed decision.
- Sign a certification stipulating that the charter application and all supporting materials contain no misrepresentations or omissions.
- Determine compliance with all applicable statutes and regulations.
- Seek advice from its own legal counsel, as appropriate.

The OCC will not accept an application for filing unless the organizers identify the CEO. (See the "Selection of the CEO" discussion in this booklet for guidance about requesting confidential treatment.)

The contact person should advise the OCC promptly whenever "significant changes" occur from the bank's original plan after the application is filed. (See "Significant Changes" discussion in this booklet.)

## **Biographical and Financial Reports**

The OCC normally requires each proposed insider to submit the Interagency Biographical and Financial Report. The OCC usually does not require insiders to complete the financial report portion of the report if a holding company will provide the new bank's financial strength (see "Types of Filings" discussion in this booklet).

Sponsors must submit a Corporate Background and Financial Report and the following or similar financial information:

- Federal Reserve Y-6 filings for the last three years.
- SEC 10K filings for the last three years.
- Annual report for the most recent fiscal period.

In the special case of a bankers' bank, the participating banks and depository institution holding companies are the organizers. Each participating bank must submit its call reports as of June 30 and December 31 for the last three years and the annual report for the most recent fiscal period. In addition, each depository institution holding company must complete a Corporate Background and Financial Report and submit financial data similar to that required from participating banks.

## **National Bank Identifying Information**

The name of the proposed bank must include the word "national" or "national association." If the exact location is unknown at the time the application is filed, the organizers must provide a "vicinity of" location. The amount of detail needed to identify the location is based on the size of the community. For instance, if the new charter will be located in a heavily populated area, the location should be specific to within 1000 feet. If the desired location is rural, identification of an area within a one-mile radius could be acceptable, if no public confusion would result. If the mailing and street addresses differ, organizers should provide both.

## **Publication Requirements and Comment Periods**

Each organizing group or sponsor must publish a notice of its charter application in a general circulation newspaper in the community in which the proposed bank will be located as close to the date of filing as practicable (see 12 CFR 5.8). If the application is an interstate filing (one that is filed by a BHC located<sup>1</sup> in a different

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<sup>1</sup> A BHC is located in the state in which the total deposits of all of its banking subsidiaries was the

state than the proposed charter), the OCC may extend the 30-day public comment period to allow sufficient time for all interested parties to comment (see the "Public Notice and Comments" booklet).

## **Types of Filings**

The OCC has two types of guidelines for charter filings: standard review and expedited review.

### *Standard Review*

Most organizing groups and many sponsors must file their charter applications using the OCC's standard submission guidelines outlined in the interagency application. These applications are subject to a 30-day comment period. A well-researched and thoughtfully prepared application helps the OCC to make a timely decision. The OCC seeks to make a decision within 120 days after receipt or as soon as possible thereafter. Charter proposals that receive standard review are not approved automatically.

### *Expedited Review*

An application to establish a full-service national bank sponsored by a BHC, whose lead depository institution is an eligible bank or eligible depository institution (see Glossary), is deemed to receive preliminary conditional approval on the 15th day after the close of the public comment period, or the 45th day after receipt of the application, whichever is later, unless:

- The OCC notifies the applicant prior to that date that the filing is not eligible for expedited review or the expedited review process is extended under 12 CFR 5.13(a)(2); or
- The OCC determines that the proposed bank will offer banking services that are materially different than those offered by the lead depository institution.

The applicant must provide identifying information about the lead depository institution for an application to qualify for expedited review. If one or more institutions are approximately the same size, the applicant must furnish additional information to support identification of the selected institution as the lead depository institution. Such information should include:

- Full legal names, locations (city and state of each main office), and OCC charter or FDIC certificate numbers for the institutions.
- Total assets for each institution as reported in the most recent call report (or comparable thrift report) and the date of that report.
- Total assets for each institution as reported in the reports of condition (or comparable thrift financial reports) as of the date one year earlier than the most recent report.

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largest on the later of July 1, 1966, or the date on which it became a BHC under the Bank Holding Company Act.

## Contracts and Other Arrangements

As part of its application, each organizing group must submit a description of any contract, transaction, professional fees, or any other type of business relationship involving the institution, the holding company, its affiliates, and any insider (see Glossary). The OCC reviews each insider contract to be sure that it is made on nonpreferential terms. If the contract involves an insider, the OCC requires the submission of at least one independent appraisal of the contract or other arrangement (see the "Investment in Bank Premises" booklet of the manual for guidelines) that includes:

- A description of the assets, property, or service.
- The terms of the contract, including responsibilities, liability, rights for audits and reviews, and termination requirements.
- Evidence showing that the contract is fair, reasonable, and comparable to similar arrangements that could have been made with unrelated parties.

The organizing group also must disclose each insider contract or arrangement to proposed or current shareholders (see the "Insider Activities" booklet of the *Comptroller's Handbook*). The organizing group must maintain copies of the disclosures in the bank's files and provide them to shareholders upon request. Typical contracts or other arrangements include:

- The sale or other transfer of any organizer's stock in the proposed national bank, including a voting trust or other voting agreement.
- An organizer acting as representative of, or on behalf of, the proposed bank or any person associated with the proposed bank.
- The payment or receipt of any money or item of value as compensation for services rendered or property transferred in organizing the proposed national bank. This may include the purchase or lease of banking premises, furniture, equipment, fixtures, or supplies; consultant or legal fees; preparation of a registration statement or nonpublic offering; or sale of stock.

Regardless of insider involvement, every contract or other arrangement should include provisions addressing obligations of, and options available to, the parties if the OCC (1) experiences delays in processing the application; (2) denies the application; (3) revokes its preliminary conditional approval letter; or (4) objects to a person serving in any proposed capacity. Such contract or arrangement would include real estate or employment commitments.

A proposed national bank may not pay any fee contingent or dependent upon an OCC action or decision. Such action is grounds for denial of the application or revocation of preliminary conditional approval.

## **Use of Third-Party Service Providers**

A bank may rely on third-party service providers for a variety of critical functions, including product delivery, information technology, loan servicing, efficiency improvement, and expertise. Before selecting each third-party service provider, the bank should perform due diligence. It also should have a formal service agreement with each provider that clearly addresses the duties and responsibilities of the parties involved and that meets the needs of the bank's business and strategic plans. *Organizers should enter into contracts contingent on preliminary conditional approval of their application.*

The organizing group should include in its application details about functions the bank will outsource and those it will perform internally. For those functions that will be outsourced, the organizers should include the name of each service provider under consideration along with related background information, number of years in business, financial condition (statements), and a copy of any contract. Also, organizers should describe the extent of due diligence conducted for each service provider that assesses the operation, evaluates the total cost pricing, and outlines criteria for ongoing monitoring of the third party and the service level.

For example, many bank customers use the telephone to conduct banking activities. Many banks have a telephone call center that operates 24 hours a day, seven days a week so that customers can conduct banking activities at their convenience. While outsourcing this call center to a service provider may be more efficient and economical, it may increase the bank's transaction, compliance, and reputation risks if customer calls are mishandled.

A bank is responsible for the security of its customer and bank records. When third-party service providers are used, the bank also must ensure that the third party secures those records properly.

The process of subcontracting activities that the bank would otherwise perform triggers the requirements of the Bank Service Company Act, in particular 12 USC 1867(c). Specifically, services performed for the bank, by contract or otherwise, are subject to OCC's regulation and examination. A bank should notify potential service providers or vendors in writing of the OCC's examination and regulatory jurisdiction should they contract with the bank. The OCC requires that all final contracts specify the OCC's examination and regulatory jurisdiction. For additional guidance, see the "Third-Party Relationships" OCC issuances included in the References section of this booklet.

Before the bank is granted final approval and allowed to open, it must develop a service provider or vendor management program. The OCC will review this program during the preopening examination. (See Preopening Examination discussion.)

## **Certification**

Each proposed organizer must sign and date the OCC certification in the interagency application. Organizers for a bankers' bank may request an exemption from the "natural person" requirement of 12 USC 21. A natural person is a human being and not a trust, corporation, or other organization or unit. If the OCC grants an



exemption to a bankers' bank, an authorized representative from each of the participating depository institutions or depository institution holding companies must sign the application. Such authorization must be evidenced by a corporate resolution from the participating institutions or holding companies.

### **Deposit Insurance and Filing with the FDIC**

The OCC generally requires FDIC deposit insurance for all national bank charters, except for national trust bank charters (see "Trust Banks" discussion). The FDIC's Statement of Policy for deposit insurance discusses the criteria the FDIC considers when evaluating deposit insurance applications, which are similar to those of the OCC. The OCC and the FDIC encourage simultaneous submission of the interagency application to each agency to expedite processing.

To the extent possible, the OCC and the FDIC coordinate their application investigations to minimize the burden to the applicant and to eliminate duplicative regulatory efforts. For example, the FDIC may rely upon OCC background investigations and may conduct its field investigation concurrently with OCC staff.

The FDIC may take final action on its deposit insurance application before the OCC decides its application. Likewise, the OCC may make its decision on the charter application prior to actions of other agencies on related applications, such as FDIC action on the deposit insurance application or Federal Reserve action on a BHC proposal.

### **Filings with Other Regulators**

If an organizing group or persons representing the same interest file substantially similar state and national charter applications, the OCC generally will consider the national bank application abandoned. The OCC may consider an exception if the organizing group requests one and unusual circumstances exist.

### **Additional Information**

The OCC may require additional information at any time to reach an informed judgment about the application. The OCC will request clarifications or additional information through the contact person. Those requests generally will not reflect negatively on the organizing group. Conversely, the OCC will deny the proposal if the additional information the organizers provide is insufficient to determine the bank's prospects for success.

### **Amendments**

Organizers may file amendments to the application during the review process. However, the OCC may conclude that the submission of numerous or significant amendments during the review period has rendered the original application obsolete. In such cases, the OCC may deem the original application to be withdrawn or deny it. The organizers must then file a new application for the OCC to consider this "new" proposal.

## Review of the Application

The OCC begins to process each application immediately upon receipt. The OCC reviews and analyzes the proposal, completes background and field investigations, and resolves any unusual or novel issues:

### **Background Investigations**

The OCC conducts background checks to assess each insider's competence, experience, integrity, and financial ability. The OCC will determine independently the accuracy and completeness of information submitted for each person. The OCC must reach a decision not to object to each insider serving in the proposed position. The "Background Investigations" booklet of the manual provides more information about this review process, the authority of the OCC to object to a filer, and actions that it may take if the materials submitted contain a misrepresentation or omission that could be misleading.

### **Field Investigations**

The field investigation is an important component in the review process for any proposed national bank charter. The findings from the field investigation are major factors in the OCC's overall analysis and review of the application. However, it is only one of the components that are evaluated prior to making a decision. The OCC conducts a field investigation for every charter sponsored by an independent group and for most BHC-sponsored charter applications. Generally, the field investigation is intended to develop background information and determine whether:

- The organizing group is capable of successfully implementing the business plan.
- Executive officers are knowledgeable and can execute the proposed business plan in a safe and sound manner.
- The financial projections are realistic for the proposed market.
- The organizers have made any major changes to the business plan that were not reported previously to the OCC.

The OCC tailors the scope of each investigation, depending on the complexity of the application, with input from the supervisory office and other OCC divisions. National bank examiners (examiners) with appropriate expertise conduct the field investigation. The OCC normally schedules a field investigation as soon as practical. Whenever possible, the OCC coordinates its investigation with that of FDIC staff to minimize burden on the applicant.

During the investigation, OCC staff members review relevant material, interview insiders and other identified persons, and explore matters related to the proposed bank's operations. The field investigation team typically discusses certain aspects of the proposal with organizers, principal shareholders, and management. Additionally, to assess market needs and support within the community, the team

may meet with community groups, local government officials, and financial (bank and thrift) and nonbank competitors.

The examiners will meet with the organizing group and management at the conclusion of the investigation to recap the field investigation and its importance to the charter decision process, discuss any significant issues, and communicate the investigation findings in general terms.

## Decision

Following review of the application and the field investigation, the OCC will determine whether the proposed bank charter has a reasonable chance of success and will be operated in a safe and sound manner. It then decides whether to grant preliminary conditional approval or deny the application. The OCC will notify the contact person and interested parties (see the "Public Notice and Comments" booklet) in writing of its decision.

Preliminary conditional approval: (1) indicates the OCC's permission to proceed with the organization of the bank according to the plan set forth in the application; (2) specifies standard requirements, including minimum policies and procedures; and (3) may identify special requirements unique to the application for the proposed bank. In addition, the OCC requires the organizers to raise capital within 12 months of the OCC's preliminary conditional approval and to open within 18 months from that date.

A preliminary conditional approval decision is not an assurance that the OCC will grant final approval for a new bank charter. The organizing group must satisfy standard and special requirements, as well as certain procedural requirements, before the OCC will grant final approval. In addition, the OCC sometimes imposes special conditions that remain in place after the bank opens.

### **Standard and Special Requirements**

When the OCC grants preliminary conditional approval to a charter proposal, it imposes standard requirements on the proposal. The organizing group must meet most of the standard requirements before opening (see Bank-Filer Samples, Standard Requirements on the OCC's Web site).

The OCC places special requirements on all new bank charters with certain characteristics, such as special purpose banks. The OCC also imposes requirements tailored to the specific individual proposal. While each organizing group must raise the minimum level of capital, net of organization costs, specified in its application, the OCC may require a group to raise an amount higher than it originally proposed. Other requirements may include:

- Submitting for review and prior approval a complete description of the bank's final information systems and operations architecture and related control plans.
- Implementing a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the bank and the nature and scope of its activities.

The organizing group generally must satisfy special requirements before the bank opens.

### **Special Conditions**

Unlike standard or special requirements, special conditions are considered "conditions imposed in writing" within the meaning of 12 USC 1818.<sup>2</sup> The OCC places two types of special conditions on new bank charters. Some apply to all new bank charters, such as obtaining the OCC's nonobjection to any significant change in the business plan prior to opening or to any significant deviation from the business plan during the first three years of the bank's operation. Others are tailored to specific proposals, such as:

- Maintaining a specified minimum capital floor.
- Maintaining a certain percentage of Tier 1 capital (leverage ratio) for a specified period after the bank opens. For example, the OCC normally expects that a new national bank will maintain no less than an 8 percent leverage ratio for the first three years of operations if it will offer a traditional array of products and services.
- Executing a written agreement between the proposed bank and its holding company that provides for capital maintenance, liquidity support, or other assurances to the bank, if and when necessary.
- Developing a contingency business plan agreement between the proposed bank and the OCC setting forth certain actions that the bank will take if the bank does not achieve original business plan results. The agreement could include, but need not be limited to, obtaining additional capital; developing and implementing a corrective action plan or new satisfactory business plan to remedy plan shortfalls or failures; or developing and implementing a contingency plan to sell, merge, or liquidate the bank at no cost to the FDIC.
- Requiring all final third-party relationship contracts to stipulate that the performance of services provided by the vendors to the bank are subject to the OCC's examination and regulatory authority.

In most cases, the OCC requires these conditions to be met by the time the bank opens and to remain in place until removed by the OCC. The OCC includes the following language in each preliminary conditional approval letter if the applicant's Certification did not contain this language:

This preliminary conditional approval and the activities and communications by OCC employees in connection with the filing do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or an officer or employee of the United States, and do not affect the ability of the OCC to exercise its

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<sup>2</sup>A condition imposed in writing is one that is enforceable under 12 USC 1818. At a minimum, the OCC will cite and include in its examination report a violation of a Regulatory Condition Imposed in Writing (RCIW). A violation of a RCIW can provide the basis for the assessment of civil money penalties or other enforcement actions.

supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

## Organization Phase

The organization phase for a national bank covers the period between the time the OCC grants preliminary conditional approval and the day the bank opens for business. During the organization phase, the organizing group must satisfy the standard requirements, special requirements, and most special conditions imposed before the OCC will grant final charter approval. In addition, the organizers hire the remainder of the bank's management team, establish the bank's premises at the proposed site, continue or begin capital raising activities, develop policies and procedures, test the information technology architecture, and establish management information and control systems.

## Establishing Bank Premises

The organizing group must decide to lease or purchase bank premises consistent with statutory and regulatory requirements (see the "Investment in Bank Premises" booklet). The organizing group finances the initial construction or acquisition of bank premises. The OCC will review lease or purchase agreements for reasonableness and will disallow any that are not made in the bank's best interest.

There are statutory limits on investments in bank premises, provided in 12 USC 371d. Unless the OCC has previously approved an exception, proceeds from the sale of stock must be held in escrow and may not be used to finance the construction or acquisition of bank premises. For example, the OCC may approve an exception if an organizer has obtained approval from the OCC to receive stock for premises the bank has purchased from the organizer.

Construction of the bank facility must comply with the minimum security standards in 12 USC 1882 and 12 CFR 21. Once open, the bank's security officer will file an annual report with the board of directors certifying that the bank complies with the stated security standards (see 12 CFR 21.4).

## Internal and External Audits

The OCC requires each national bank to adopt an internal audit system appropriate to its size, nature, and scope of activities. Some new banks may elect to adopt a system that incorporates independent reviews instead of dedicated audit staff (see the "Internal and External Audits" booklet of the *Comptroller's Handbook*). An effective audit program will include an evaluation of the quality of internal controls, including the reliability of financial information, safeguarding of assets, and the detection of errors and irregularities.

As a condition of preliminary approval of a newly chartered national bank, the OCC and the FDIC normally require banks to have an annual independent external audit for a period of three years after they open. The external audit must be of sufficient scope to enable the auditor to render an opinion on the financial statements of the bank or consolidated holding company.

The first audit should occur no later than 12 months after the bank opens for business. For example, if a bank becomes a body corporate on April 15, the audit period must begin on April 15 and may end no later than March 31 of the following year. Since most banks adopt a calendar year end, the first audit normally would be performed as of December 31 of the year the organizers form the bank as a body corporate.

The OCC may grant exemptions from this external audit requirement to a new bank subsidiary of a BHC when all of the following requirements are met:

- The new bank's financial statements are included in the audited consolidated financial statements of the parent BHC.
- The sponsoring BHC is an existing holding company that has operated for three years or more under Federal Reserve Bank supervision and does not have any institutions subject to special supervisory concerns.
- Adequate internal audit coverage will be maintained at the bank level. At a minimum, the internal audit program must evaluate the quality of internal controls, including the reliability of financial information, safeguarding of assets, and the detection of errors and irregularities.

The OCC and the FDIC will coordinate determinations about external audit exemptions consistent with the "Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations." This statement focuses on banks holding less than \$500 million in total assets. If the OCC grants an exemption, it will include that determination in its preliminary conditional approval letter. If any of the requirements listed above are not met during the first three years of the bank's operation, the OCC may withdraw the exemption at its discretion.

Management of new banks should be aware of the general limitations contained in the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). Sarbanes-Oxley prohibits an accounting firm from acting as an external auditor of a public company during the same period that the firm provides internal audit outsourcing services. This prohibition applies to companies with securities registered with the Securities and Exchange Commission (SEC) or a federal banking agency. Accordingly, national banks that are subject to the Securities Exchange Act Disclosure Rule requirements of 12 CFR 11 and 16 would be covered by separate audit requirements.

## Fidelity and Other Insurance

The bank's board of directors is responsible for the adequacy of the fidelity bond and other insurance needs. They must research and document in meeting minutes their assessment of the bank's fidelity insurance and excess coverage needs.

After the bank opens for business, it must assess the four factors listed in 12 CFR 7.2013 and obtain adequate fidelity bond coverage. They are:

- Internal auditing safeguards employed.
- Number of employees.

- Amount of deposit liabilities.
- Amount of cash and securities normally held by the bank.

The OCC will not grant final approval of the charter until the bank has selected a permanent fidelity insurance carrier. The OCC must receive assurances from the bank that permanent insurance coverage will be in place on or before the bank's proposed opening date.

A bank also may acquire liability insurance to mitigate any loss it might incur for inadequate or faulty systems. Some insurance companies offer specialty policies to businesses that assume the risk of legal liability, including errors and omissions. Errors and omissions policies usually cover lawsuits from negligence and performance failure of a product or service.

## Start-Up Costs, including Organization Costs

Start-up costs (see Glossary), including organization costs, of a national bank must be funded by the organizers and founders through their own funds or borrowings. (See the Repayment of Start-up and Organization Costs to Organizers section in this booklet.)

At the first shareholders' meeting, shareholders review documentation for start-up costs, including organization costs, and commitments, evaluate their reasonableness, and authorize them as appropriate. Therefore, it is important that all start-up costs be adequately documented and fully disclosed to shareholders. Any public or private offerings of securities and proxy materials must properly disclose all fees and start-up costs to prospective shareholders.

For a new bank, pre-opening expenses (such as salaries and employee benefits, rent, depreciation, supplies, directors' fees, training, travel, postage, and telephone) and organization costs (the direct costs incurred to incorporate and charter the bank) are considered start-up costs. These costs cannot be capitalized but must be expensed as incurred.

On the other hand, costs of acquiring or constructing premises and fixed assets and getting them ready for their intended use are expenses that should be capitalized rather than treated as start-up costs. However, the costs of using such assets during the start-up period (such as depreciation) are considered start-up costs.

The start-up costs of forming a bank are sometimes paid by the organizing group (or founders or holding company) without reimbursement from the bank. This may occur because it is the desire of the organizing group (or founders or holding company) to contribute these funds, which is considered a "forgiveness of payment." Accordingly, the bank must record these start-up costs as expenses of the bank, with a corresponding entry to surplus to reflect the capital contribution. This includes services that are provided by the holding company, such as legal or accounting expertise. In this case, the holding company should account for the cost of services, including salaries, and the bank should record them as start-up costs.

If the shareholders or the OCC disallow reimbursement of certain costs, the organizers, founders, or holding company personally are responsible for paying the

expenses. The bank should treat such unreimbursed costs as capital contributions by the organizers, founders, or holding company. Accordingly, the bank must record these unreimbursed organization costs as expenses of the bank, with a corresponding entry to surplus to reflect the capital contribution.

Similarly, the organization costs of forming a holding company and the costs of other holding company start-up activities are sometimes paid by the banks. Because these are the holding company's costs, they should not be reported as expenses of the bank. Accordingly, any unreimbursed costs paid by the bank on behalf of the holding company or organizers or founders should be reported as a cash dividend. This treatment as a dividend is required whether or not the holding company formation is successful.

Under certain circumstances, the actual amount of start-up costs for the bank that are reimbursable may substantially exceed the amount projected when the application was filed initially. In such cases, the OCC may require that the organizing group raise additional capital to offset such unplanned or unanticipated expenses.

The bank should report start-up costs incurred from the bank's inception (including the period prior to receiving its charter) through the date it commences operations on the income statement during the calendar year that the bank begins operations. Detailed instructions for the definition of organization costs and the inclusion of these costs in the bank's report of income are included in the "Start-up Activities" section to the call report. This guidance conforms to AICPA Statement of Position 98-5, "Reporting on the Costs of Start-up Activities." (See OCC Bulletin 98-29: Accounting for Computer Software Costs.)

## Significant Changes

Proposed changes throughout the chartering process may alter materially the underlying factors upon which the OCC based its decision on the application.

Those changes may have a positive or negative effect on the application. The OCC will evaluate each significant change to the original charter proposal to determine the overall impact on the proposal and decide whether to:

- Allow organization of the bank to continue.
- Impose additional conditions on the approval.
- Revoke preliminary conditional approval.

In some cases, the OCC may consider the change so materially different from the original application that the OCC will consider the application abandoned. In such cases, the OCC requires the organizers to submit a new application.



## Identification

Licensing staff will maintain contact with the contact person throughout the organization phase and monitor any deviation from the business plan to identify significant changes. Organizers must notify the OCC promptly of significant changes when they occur or are proposed. Matters subject to this notification include, but are not limited to, changes in the:

- Organizing group's cohesiveness or its composition, including the addition or loss of organizers, directors, or principal shareholders.
- CEO or other members of the proposed management team.
- Biographical or financial information of the CEO or organizers different from what they previously disclosed to the OCC.
- Ownership distribution (see the "Ownership and Capital Raising Efforts" discussion that follows).
- Manner in which the organizers raise capital, if different than what is described in the charter application (see the "Ownership and Capital Raising Efforts" discussion that follows).
- Development of, or a change in the terms to, a stock benefit plan.
- Business plan, including changes to proposed products, services, activities, growth plans, marketing plans, risk profile (such as more aggressive underwriting criteria or adding a fiduciary operation to a commercial bank's operations), or risk management controls.
- Location of the main or branch offices.

## Ownership and Capital Raising Efforts

The OCC will review the shareholders' list prior to, or during, the preopening examination to confirm that the organizers' and directors' subscriptions are consistent with their original stock purchase commitments. The OCC also reviews stock subscriptions for potential control issues as specified under 12 USC 1817j and 12 CFR 5.50. The OCC also will verify that the organizing group's effort to raise capital is consistent with the plans described in the application. Failure to raise capital, as described, is an example of a deviation that can occur late in the chartering process. For example, organizers may make last-minute material capital contributions, or a BHC may purchase stock in a bank that originally planned to raise capital in the local community.

Licensing staff will consider if a deviation from described capital-raising efforts has the effect of constituting a sale of the charter because of a material change in ownership. In some cases when the deviation strengthens a proposal without

altering other aspects, such as implementation of the business plan, the OCC may decide not to require submission of a new application.

## Repayment of Start-up and Organization Costs to Organizers

Organizers and founders may not be reimbursed for personal loans or advances of funds made to the bank organizing effort until after the capital funds are deposited in the bank, the shareholders authorize repayment, and the OCC authorizes release of the escrowed capital funds. When it opens for business, the bank can repay organizers or founders in cash. Alternatively, the organizing group may request prior OCC approval so that an organizer can receive stock, or a combination of stock and cash. The OCC will authorize release of escrowed capital funds provided that:

- The organizers provide information to demonstrate that any transaction, contract, professional fees, or any other type of business relationship involving the institution, the holding company, and its affiliates (if applicable):
  - Is made in the normal course of business,
  - Is made on substantially the same terms as those prevailing at the time for comparable transactions with non-insiders, and
  - Does not present more than the normal risk of such transaction or present other unfavorable features.
- The organizers document and properly disclose in any public or private offering of securities and proxy materials the expenses incurred by the organizing group in order for investors (shareholders) to evaluate the appropriateness and reasonableness of the expenses.
- The stock is issued at no less than par value.

## Preopening Examination

The preopening examination (POE) is the last major step of the chartering process for national banks. Organizers submit a request to the OCC to schedule this examination at least 60 calendar days before the proposed opening date. An examiner will visit the bank at least 14 calendar days prior to the proposed opening date to determine whether the board of directors and management are prepared to commence operations.

The examination may be broad in scope and include an evaluation of the bank's final plans to identify, measure, monitor, and control all relevant risks. (See Appendix D for information about the categories of risk and risk assessment.) After the preopening examination, the examiner will meet with the board of directors and management to discuss examination findings.

The OCC may decide on a case-by-case basis to waive or perform an abbreviated POE for an organizing national bank sponsored by an existing BHC or other sponsoring company. The OCC will base its decision primarily upon the OCC's prior knowledge of, and experience with, the sponsor and the sponsor's policies and procedures. At a minimum, each BHC-sponsored organizing national bank that will

not receive an on-site review must certify completion of certain organizational procedures and file remaining corporate documents with the OCC.

## Expiration or Revocation of Preliminary Conditional Approval

A bank must raise initial capital, net of organizational and preopening expenses, to meet or exceed the amount stated in the preliminary conditional approval letter. If the capital for the new bank is not raised within 12 months of the preliminary conditional approval, the organizing group fails to meet the market test (see Glossary) and preliminary conditional approval expires. The OCC generally will not extend the time for raising capital.

If the organizers raise capital within the deadline, they must open the bank no later than 18 months from the date the OCC granted preliminary conditional approval. The OCC's preliminary conditional approval also expires for failure to open the bank within 18 months.

### Extensions

The OCC normally does not grant extensions of time for either deadline. Under extenuating circumstances, the organizing group may request an extension of the time following approval from the Licensing staff in the appropriate district office. The organizing group must provide sufficient information with its request to prove that the reason for the delay is beyond its control (for example, unforeseeable environmental cleanup that the organizers must complete before they can build a facility).

### Revocation

The OCC will revoke preliminary conditional approval if:

- The OCC discovers material violations of law, misrepresentations, or any fraudulent activity by the organizers, directors, or officers.
- Prior to opening, the OCC learns of any information that gives it sufficient cause to:
  - Change its evaluation of the proposed new national bank's prospect for success (such as significant changes in proposed senior management, status of ownership or directors, deterioration of an affiliate institution, or a change in capitalization or deposit insurance status).
  - Question that the bank will be operated in a safe and sound manner.

### Notification

The OCC will convey reasons in writing why it denied an application or withdrew preliminary conditional approval. The organizing group, directors, and founders alone are responsible for all expenses incurred for a withdrawn, expired, or disapproved application, including costs for returning funds to subscribers. They personally must pay all expenses incurred regarding the proposal.

## Final Approval

The OCC determines whether a bank will be authorized to open. A national bank may begin the business of banking or engage in fiduciary activities only when the OCC grants final approval. The OCC may delay opening if:

- During the POE, the examiner identifies deficiencies that the directors must correct prior to opening. Such deficiencies may include systems or bank premises that are not ready to support bank operations.
- The directors have not selected a fidelity insurance carrier, or the fidelity insurance coverage will not be in effect when the bank opens.
- The OCC determines through other means that a significant change has occurred or that the organizing bank is not prepared to open. Significant deviations or changes that the OCC has not approved during the organization phase may be grounds for delaying issuance of the charter or revoking its preliminary conditional approval.
- The OCC determines that the organizers have not adequately addressed any substantive risk management concerns identified in the chartering process or POE.

The OCC imposes the following standard condition on each preliminary conditional and final approval:

The bank shall: (i) give the (insert the appropriate OCC supervisory office) at least sixty (60) days prior written notice of the its intent to significantly deviate or change from its business plan or operations,<sup>3</sup> and (ii) obtain the OCC's written determination of no objection before the bank engages in any significant deviation or change from its business plan or operations. The OCC may impose additional conditions it deems appropriate in a written determination of no objection to a bank's notice. This condition shall remain in effect during the bank's first three years of operation. [For insured charters only insert: "For the first three years of operation, the bank also must provide a copy of such written notice of its intent to significantly deviate or change from its business plan or operations to the FDIC's (insert the appropriate regional FDIC supervisory office) regional office."]

This condition of approval is a condition "imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 USC 1818. As such, this condition is enforceable under 12 USC 1818.

Until final approval is granted, the OCC has the right to alter, suspend, or revoke preliminary conditional approval should the OCC deem that any interim development warrants such action.

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<sup>3</sup> If such deviation is the subject of an application filed with the OCC, no separate notice to the supervisory office is required.

## Post-Opening Considerations

The OCC continuously supervises national banks through on-site supervisory activity and periodic off-site monitoring. (See the "Large Banks Supervision" and "Community Bank Supervision" booklets of the *Comptroller's Handbook*.) Those activities help determine the condition of individual banks and the overall stability of the national banking system. (Also see Appendix D in this booklet.)

## Significant Deviations After Opening

A bank's significant deviations (see Glossary) or changes from its proposed business plan after opening for business may alter materially the underlying factors upon which the decision to grant final approval of the charter application was based. Those deviations may have a positive or negative effect on the bank. A new national bank may not change its operations significantly without the OCC's review and nonobjection for the bank's first three years of operation.

After a bank opens for business, management and the board may discover that the bank is achieving slower or more rapid growth than anticipated. Management and the board also may determine that the bank is not able to generate quality loans or attract a significant volume of deposits. There also may be concerns about poor risk management practices. Management and the board should investigate thoroughly the underlying reason(s) for each item before taking action.

Examiners will evaluate proposed significant deviations to determine if they are prudent. (See Appendix G for specific guidance on identifying and evaluating significant deviations, communication requirements, and related procedures.)

## Expansion or Contraction of Assets or Activities

Apart from the significant deviation requirements, bank management that wishes to expand or contract the bank's primary business may need to file with the OCC prior to implementing the proposed change. (Refer to this same subject in the General Policies and Procedures booklet for specific details.)

The OCC has a long-standing practice of discouraging a national bank from removing substantially all of the assets and liabilities of the bank, creating a dormant bank or shell operation (see Glossary). The OCC has serious supervisory concerns including how the management or the board may use such a dormant charter; the nature of the services and products that might later be initiated; and increased operations and concentration risk. For a detailed discussion, refer to the General Policies and Procedures booklet.

## Change in Control

Unless a transaction is subject to the Bank Merger Act (12 USC 1828(c)) or other statutory exemptions, the OCC will apply the definitions and standards in the Change in Bank Control Act (CBCA) and the OCC's implementing regulation (12 USC 1817(j) and 12 CFR 5.50, respectively) to determine whether a change in ownership interest constitutes a change in control. This includes transactions that

may result in control following the exercise of warrants or options by insiders under stock benefit plans.

If the OCC finds that a change in control would result from a change in ownership, the OCC will require the new owner(s) to file a change in control notice, generally, prior to the proposed transaction. The OCC will then decide whether to disapprove the proposed change. No person (see Glossary) may take any action that would result in a change in control of the bank without prior OCC review, as provided in the CBCA, unless the transaction is subject to approval under certain other statutes (see the "Change in Bank Control" booklet).

## OCC Review of Management

The OCC must review and not object to the hiring of any officer or the appointment or election of any director for two years from the date the bank commences business. During this time period, each person proposed as an officer or director must provide the appropriate OCC supervisory office with the required Interagency Biographical and Financial Reports. The OCC will provide a written decision about each person submitted for review.

## Special Purpose or Narrow Focus Proposals

A national bank is authorized by its charter to exercise all express or implied powers of national banks. Special purpose or narrow focus banks offer only a small number of products, target a limited customer base, incorporate nontraditional elements, or have narrowly focused business plans.

Special purpose banks and those with a narrow focus must meet the same statutory and regulatory requirements as other nationally chartered banks, unless applicable laws or regulations provide otherwise. Organizers of such banks must adhere to established charter policies and procedures that are set forth in 12 CFR 5 and this manual. Organizers should tailor the contents of the application to be consistent with the special purpose or narrow focus nature of the proposed charter.

The OCC's review of a special purpose or narrow focus proposal may exceed traditional processing time frames because of the time needed to evaluate the supervisory risks associated with each application. Special purpose and narrow focus bank charter applications normally must provide the information required by the OCC's standard review process. The OCC requires each special purpose or narrow focus bank to indicate the nature of its operations in its articles of association.

## Types of Special Purpose Banks

Special purpose proposals include those banks whose operations are limited to credit card operations, fiduciary activities, community development, or cash management activities. Bankers' bank proposals also fall into this category.

### Credit Card Banks

National credit card banks take two basic forms. First, a BHC or individual shareholders may own an insured bank that engages exclusively or predominantly in

credit card activities. This bank may legally offer additional commercial banking services unless prohibited by its articles of association. The bank may expand its activities by following the Expansion or Contraction of Activities requirements previously discussed in this booklet. These banks are "banks" under the Bank Holding Company Act (BHCA), and so a company that owns one is a BHC subject to the activity and geographic limitations of the BHCA.

Second, there are insured national credit card banks that are not "banks" under the BHCA. The Competitive Equality Banking Act of 1987 (CEBA) created the BHCA exemption for these banks (CEBA credit card banks). The company that owns a CEBA credit card bank does not become a BHC solely by virtue of owning the bank, and so the parent company is not subject to the activity and geographic limitations generally applicable to BHCs under the BHCA. Thus, nonbank holding companies, commercial entities, or banks that wish to have a subsidiary credit card bank usually own these banks. However, a BHC that wants to operate a credit card bank in a state in which it is not able to establish a *de novo* BHCA bank also could own a CEBA credit card bank in that state. This type of bank must meet all of the requirements for the credit card bank exemption created by the CEBA amendment to the BHCA (12 USC 1841(c)(2)(F)). The bank:

- Must engage only in credit card activities.
- May not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties.
- May not accept any savings or time deposits of less than \$100,000, unless they are used as collateral for secured credit card loans.
- May maintain only one office that accepts deposits.
- May not engage in the business of making commercial loans.

Those limitations must appear in the bank's articles of association.

Although commercial entities may have proven experience in managing a credit card operation, the OCC expects a senior management team that can demonstrate sufficient banking experience necessary to operate as a national bank in a regulatory environment. A CEBA credit card proposal will be processed as a narrowly focused charter application. Proposals with any of the following features will be subject to greater scrutiny:

- Issuance of cards with closed-end credit features.
- The absence of a parent organization with an investment grade rating of A or higher by Moody's or Standard and Poor's.
- Issuance of cards to low- and moderate-income (LMI) customers with a higher credit risk profile or higher default probabilities, large upfront fees, higher than usual annual percentage rates, or collateral issues (collectively, subprime lending issues).
- E-banking and Internet primary operations.

Each applicant should evaluate thoroughly and discuss potential issues with appropriate OCC staff before filing. Third-party relationships or vendor management issues may increase significantly a bank's risk profile, notably strategic, reputation, compliance, and transaction risks. (See the "Third-Party Relationships" section in this booklet.) Because those issues are sometimes complex, an applicant also may wish to consult its regulatory counsel.

A credit card bank must maintain its status as an "insured depository institution" within the meaning of 12 USC 1813(c)(2) and apply for membership in the Federal Reserve System. If the FDIC initiates or takes any action to terminate the bank's status as an "insured depository institution," the OCC reserves the right to impose additional conditions upon the bank.

A credit card bank also must comply with the CRA. However, it may seek designation as a limited-purpose bank under 12 CFR 25.25 for CRA purposes.

Many credit card bank proposals raise affiliate transactions issues under sections 23A (12 USC 371c) and 23B (12 USC 371c-1) of the Federal Reserve Act and the implementing regulation, Regulation W, 12 CFR 223. The most common issues relate to:

- Initial capitalization of a newly chartered credit card bank.
- Transfers of assets between the credit card bank and its affiliates.
- The possibility that credit extended by a proprietary credit card bank to its cardholders may be treated as a loan to an affiliate, if customers use their credit cards to purchase goods and services from bank affiliates.

Regulation W contains an exemption from the restrictions of sections 23A and 23B that permits a newly formed bank to purchase assets from an affiliate, thus eliminating many of the issues pertaining to providing initial capitalization of any new bank, including a credit card bank.

Under section 23A's attribution rule, an extension of credit by a member bank to a nonaffiliated entity is treated as an extension of credit to an affiliate if the proceeds are transferred to, or used for the benefit of, an affiliate of the bank. These transactions thus become covered transactions. Accordingly, if a credit cardholder purchases goods or services from an affiliate of the member bank that issued the credit card, then the extension of credit to the cardholder is attributed to the affiliate because the affiliate receives the benefit of the loan proceeds.

Regulation W contains complex rules regarding the treatment of credit cards under the attribution rule. The regulation provides an exemption from the attribution rule if the extension of credit is made through a "general purpose credit card." This is a credit card issued by a member bank that is widely accepted by merchants that are not affiliates of the bank and that satisfies a test set forth in the regulation. Specifically, the value of goods and services purchased with the card from affiliates of the bank must be less than 25 percent of the total value of all goods and services purchased with the card. Compliance with the test may be demonstrated in several ways. Organizers of a CEBA credit card bank with a sponsoring company should consult the regulation for details. If a card fails this test, all card transactions with affiliates are subject to the attribution rule.



Issuers of credit cards that cannot qualify as general purpose credit cards may still avoid the collateralization and other requirements for covered transactions by making use of the exemption provided in Regulation W for an intraday extension of credit. This is defined as an extension of credit to an affiliate that the bank expects to be repaid, sold, or terminated, or to qualify for a complete exemption under Regulation W, by the end of the United States business day. CEBA credit card banks commonly qualify for this exemption by selling their receivables to an affiliate or other entity at the end of each business day. Organizers of a CEBA credit card bank with a sponsoring company should consult the regulation concerning requirements to qualify for the intraday exemption.

### **Trust Banks or Trust Companies**

The OCC may grant approval for a national bank that will limit its operations to those of a trust bank and activities related to trust services pursuant to its authority in 12 USC 27 and 92a and the licensing requirements in 12 CFR 5.20 and 5.26. National banks that choose to so limit their services are referred to as national trust banks or national trust companies (trust banks). Most trust banks choose not to apply for deposit insurance; however, FDIC insurance may be available for national trust banks, and the organizers should consider applying for it, if appropriate.

An organizing group or sponsor seeking to charter a trust bank should review this booklet as well as the "Fiduciary Powers" booklet. The OCC requires that a national trust bank's articles of association limit the bank to the exercise of fiduciary powers and incidental activities.

A trust bank typically is not a bank for purposes of the BHCA, and so a company other than a BHC may own a trust bank. There are two ways for a trust bank not to be a bank under the BHCA. First, a trust bank does not meet the general definition of a bank under (12 USC 1841(c)(1), if the trust bank (a) is not insured and (b) does not accept demand deposits and make commercial loans. Second, even if a trust bank is insured and otherwise would meet the definition of a bank, a trust bank is not considered a bank for purposes of the BHCA if it meets certain conditions (12 USC 1841(c)(2)(D)). These conditions are:

- The institution must function solely in a trust or fiduciary capacity.
- All or substantially all of the trust bank deposits are in trust funds and are received in a *bona fide* fiduciary capacity.
- No trust bank deposits insured by the FDIC are offered or marketed by or through an affiliate.
- The trust bank does not make commercial loans or accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others.
- The trust bank may not obtain payment or payment-related services from any Federal Reserve Bank.

- The trust bank may not exercise Federal Reserve Bank discount or borrowing privileges.

Transactions with uninsured banks are subject to special restrictions under sections 23A and 23B of the FRA, as implemented by Regulation W. For instance, a bank's transactions with an uninsured trust bank owned directly by the same parent company do not qualify for certain exemptions from sections 23A and 23B that are available to a bank engaging in the same transactions with an *insured* bank affiliate. Thus, transactions between the bank and its uninsured trust bank affiliate generally must comply with all relevant requirements of sections 23A and 23B.

On the other hand, an uninsured trust bank that is wholly owned by a bank is not treated as an "affiliate" of the parent bank for purposes of sections 23A or 23B. Thus, from the perspective of the parent bank, transactions between the parent bank and the subsidiary uninsured trust bank are exempt from sections 23A and 23B. From the perspective of the uninsured trust bank, sections 23A and 23B apply to covered transactions with the bank parent but the so-called sister bank exemption or another exemption may be available.

Organizers of a trust bank or a bank that will operate a trust department should include the following information in the charter application:

- Detailed pro forma financial reports. Organizers should provide projections for three years or until stable profitability is achieved, whichever period is longer.
- A timetable that demonstrates how and when the trust bank will achieve stable profitability.
- A comprehensive alternative business strategy. This alternative strategy should articulate plans to manage potential scenarios in which revenue, margins, or expenses differ significantly from original plans. In addition, it should include a realistic plan for how the bank would access additional capital, if needed, or ultimately liquidate or exit the national banking system, if necessary.
- If a charter application involves an existing trust operation, copies of the last three years' annual regulatory reports relating to the trust operations (such as the year-end RC-T schedule from the call report and financial reports filed with state regulators).
- Representations that the trust bank:
  - Shall not make any major acquisition(s) of fiduciary or fiduciary-related assets or services from another bank or company during its first three years of operation without the prior written approval of the appropriate OCC supervisory office.
  - Will consult with the appropriate OCC supervisory office prior to undertaking an aggressive or significant expansion of its trust operations into another state or prior to undertaking any geographic expansion that poses novel or problematic legal issues.

- Will consult with the appropriate OCC supervisory office prior to offering any service or product, either in its home state or another state, where the bank's ability to supervise the activity will be limited because of its reliance on nonbank personnel or limited staff or resources to market or administer the bank's fiduciary or fiduciary-related services.
- Shall file quarterly call reports, prepared by someone with appropriate financial management experience, in accordance with relevant instructions.

Trust banks are required by statute (12 USC 92a) to have capital no less than that required by state law for companies offering similar services in the state in which the bank will be located. In addition, the balance sheet assets of a national trust bank are subject to the minimum leverage and risk-based capital ratios defined in 12 CFR 3. However, these ratios are not optimal measures of capital adequacy for national trust banks because off-balance-sheet asset management activities are not captured in the capital ratio calculations. Accordingly, the OCC expects organizers for national trust bank charters to provide a detailed analysis supporting their proposed capital level. Organizers should use the analysis factors outlined in OCC Bulletin 2007-21 as a guideline for capital adequacy analyses.

Based on the OCC's assessment of risk, management, and the ability of the bank to raise capital after commencing operations, the OCC may impose as a condition of approval for a national trust bank charter application initial and minimum capital requirements above those required by statute and regulation. In addition, the OCC may impose a separate special condition on a national trust bank charter that would trigger Prompt Corrective Action-type remedies should the bank fail to maintain the specified minimum capital level. Further, if a national trust bank's assets under management increase significantly, or the national trust bank assumes additional risk, the OCC may require the bank to maintain higher levels of capital. In determining the appropriate capital and other supervisory safeguards, the OCC considers whether or not the proposed trust bank is a subsidiary of a national bank or BHC or otherwise has a financially strong parent that can provide support.

Organizers of a national trust bank should refer to OCC Bulletin 2007-21, for further guidance on OCC expectations of national trust bank directors and management to ensure that adequate capital and liquidity are maintained at national trust banks. In addition, organizers should refer to recent national trust charter approvals available in Interpretations and Actions on the OCC's Web site to gain insight into the OCC's capital expectations for national trust bank charters.

### **Community Development Bank**

A community development (CD) bank is a depository institution with a stated mission to primarily benefit the underserved communities in which it is chartered to conduct business. A CD bank pursues this specialized mission by providing financial services to LMI individuals or communities or benefiting other areas targeted for redevelopment by the local, state, tribal, or the federal government. The bank's articles of association must indicate the express intent to lend, invest, and

provide services primarily to LMI individuals or communities in which it is chartered to conduct business. Typically, this means that the CD bank's activities will support one or more of the following activities:

- Affordable housing, community services, or permanent jobs for LMI individuals.
- Equity or debt financing for small businesses.
- Area revitalization or stabilization.
- Other activities, services, or facilities that primarily promote the public welfare.

The CD bank charter makes it possible for other banks to invest in the institution pursuant to the investment authority of 12 USC 24 (Eleventh) and 12 CFR 24 in addition to the investments that might be possible under 12 USC 24 (Seventh) and 12 CFR 5.36. For additional guidance regarding 12 CFR 24 or 12 CFR 5.36 requirements for national banks with a CD focus, see the OCC memo to "Prospective Community Development Bank Organizing Groups."

The OCC provides technical assistance to organizers of each CD bank to assist in addressing unique features associated with each application. OCC staff will respond to the group's questions and communicate options to assist in accomplishing the organizers' objectives.

As part of providing technical assistance, the OCC encourages groups to explore fully unique aspects of their proposals prior to submitting a draft for OCC staff review. The OCC will review **one** draft application for the organizing group. The OCC's technical assistance on the bank's proposal ends when the charter application is filed. OCC technical assistance does **not** include providing instructions and direction to the bank organizers on developing a business plan, creating the group's strategies, or actually preparing the proposal or application.

### **Cash Management Bank**

A cash management national bank normally is affiliated through a BHC structure with other banks that engage in a full array of commercial activities. A cash management bank provides certain financial services to its large corporate customers. In the cash management bank, all accounts are swept into money market mutual funds or repurchase agreements of the cash management bank at the end of each day as each customer clears its accounts daily to zero. Fees for services typically are charged to each customer based on the number of services used and the number of items processed. Cash management banks incur high operational risks.

Some cash management banks are chartered as *de novo* institutions. However, most are created by stripping down the operations of an existing bank to those of a cash management bank following a purchase and assumption transaction. In the latter case, a bank must follow the "Contraction of Activities" requirements provided in the "General Policies and Procedures" booklet.

A key consideration when a bank alters its operation in this manner is the appropriate level of capital. The BHC may wish to reallocate its capital and reduce capital in the cash management bank (see the "Capital and Dividends" booklet). Normally, the OCC will expect capital at the cash management bank to be maintained at the "well-capitalized" level as defined in 12 CFR 6.4(b)(1).

The CRA does not apply to a special purpose bank that is engaged only in providing cash management, controlled disbursement services to the public.

### **Bankers' Banks**

A group organizing a bankers' bank (see Glossary) may request that the OCC waive compliance with certain statutes or regulations based on their operations. Requests for such waivers should accompany the application and must be supported by adequate justification and legal analysis. The OCC will review each waiver request by a national bankers' bank and decide whether it is justified. However, the OCC cannot waive statutory requirements that apply specifically to a bankers' bank.

National banks investing in a bankers' bank may own no more than 5 percent of any class of its voting securities. In addition, a national bank's total investment in the stock of one or more bankers' banks is limited to 10 percent of the investing bank's unimpaired capital and surplus.

Stock in a bankers' bank may be sold only to depository institutions or their holding companies. The CRA does not apply to bankers' banks that do not perform commercial or retail banking services by granting credit to the public in the ordinary course of business, other than as incidental to their specialized operations.

## **Narrow Focus Proposals**

The OCC receives numerous inquiries and proposals from individuals and groups expressing interest in establishing a national bank to conduct new business or transfer existing operations into a new bank. Organizers of banks that will have a narrow focus propose to offer limited services or anticipate serving a narrowly defined market niche. For example, an organizing group may propose a lending portfolio that is heavily concentrated or targets a restricted customer base.

### **Supervisory Risks**

Certain supervisory risks, such as credit risks, will be increased in a narrow focus bank due to its concentration in a single, or a very limited number of, business activities. The OCC may discourage the filing of or deny a charter proposal that would focus primarily or exclusively on activities or services that will carry a high degree of risk or are determined to be predatory in nature.

The OCC requires any proposal for a narrow focus bank to have well-defined business strategies (including contingency plans, sound funding sources, and projected capital commensurate with the risks) and specialized management. The OCC will review each business plan for a narrow focus proposal to ensure that the organizers address adequately the following risks:

- *Concentrations.* Narrow focus banks, by their very nature, are not as diversified as traditional banks, and a bank's business plan should address how the bank will mitigate any concentration risk. Diversified asset and liability portfolios, product selection, funding sources, and target markets help make a bank less vulnerable to a downturn that could significantly affect its income, liquidity, or asset quality.
- *Funding and liquidity.* The organizers should clarify in the business plan how the bank's sources of funding are reasonably diverse, how it intends to maintain adequate liquidity, and how credit-sensitive funding risks will be managed.
- *Access to capital.* The business plan should identify sufficient capital to address uncertainties and provide a clear ability to raise capital, if needed. Initial capital should be sufficient, at a minimum, to support the bank's operations and absorb anticipated losses until profitability is achieved, while maintaining capital at an appropriate level to support safe and sound operations. If the bank fails to achieve its projected levels of profitability, the OCC expects the directors to take steps to restore capital to an adequate level. Depending on the risk profile of a narrow-focused bank's business plan, the OCC may require higher capital levels. This level of initial capital is particularly important if the bank relies on an Internet-only platform for distribution of products and services.
- *Customer authentication and security.* The application of a bank using the Internet as a significant means of product delivery must address authentication and security issues. The bank's method of customer authentication and fraud detection is critical because of the lack of personal contact with bank customers. Internet banking platforms allow bank customers to access information and systems directly, including those that enable funds transfers between banks (such as automated clearing houses, SWIFT, Fed Wire, and CHIPS). Also, pursuant to the Bank Secrecy Act, banks must report and record customer transactions that exceed certain thresholds. In an Internet environment, a bank may need to modify its systems for monitoring customer transactions. (Refer to the FFIEC IT Examination Handbook Series; E-Banking booklet, dated August 2003, for specific information.)
- *Strategic planning.* Narrow focused banks often target a limited customer base and frequently have ill-defined contingency plans for redirecting efforts should the business plan prove unsuccessful. Organizers should define clearly in the business plan their targeted audience (for example, by identifying products and geographic areas) and the strategic alternatives. In developing the strategic plan, the organizers must keep potential conflicts of interest in mind. (See "Conflicts of Interest" previously discussed.)

## **CRA Policy Issues**

The CRA does not apply to uninsured banks and certain special purpose banks, such as bankers' banks and banks that engage in only the following activities: providing cash management controlled disbursement services or serving as correspondent banks, trust companies, or clearing agents (see 12 CFR 25.11(c)(3)). In those cases, the organizers may omit the CRA plan discussion from the business plan.

Some other banks may seek designation as a limited-purpose or wholesale bank (see 12 CFR 25.12(o) and (w), and 12 CFR 25.25(b)). A limited purpose bank offers only a narrow product line, such as credit card or motor vehicle loans, to a regional or broader market. A wholesale bank is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers.

The organizers must submit a request, in writing, with the charter application to be designated as a limited purpose or wholesale bank. As limited purpose and wholesale banks are subject to evaluation under the community development test, the organizers should submit a targeted discussion of the bank's CRA plan as part of the charter application.

## **Capital Considerations**

The OCC requires proposed banks with higher risk profiles to have higher capital reserves than banks that present lower risk. The OCC normally does not approve tiered capital injections during the first three years of the business plan unless the bank has an established parent company to serve as a source of capital strength. Therefore, the business plan must indicate that all necessary capital for the three-year plan will be available upon opening.

## Procedures: Prefiling

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### Exploratory Inquiry, Conference Call, or Meeting

#### Licensing Staff

1. Forwards any requested information on OCC's policies and procedures for establishing a national bank to the contact person or spokesperson (contact person) for the organizing group. Notifies the appropriate district supervisory staff of the contact made, if not originated through the supervisory office.
2. If necessary, contacts Headquarters Licensing (HQ LIC) about an inquiry, providing names of the organizers, proposed location (city, state), business lines, and any issues raised.

#### Organizers

3. May request an exploratory conference call or meeting through the contact person to clarify any questions or concerns. If available, mail or fax a copy of any written documents that describe the proposal to the director for district Licensing (LIC) for review *prior* to the call or meeting. Allow adequate time for OCC staff to review the material.

#### Licensing Staff

4. Schedules an exploratory conference call or meeting with proposed organizers along with the appropriate district supervisory, legal, and, in some cases, OCC headquarters staff. The organizers may choose to include counsel and consultants in discussions and meetings with the OCC.
5. Conducts a conference call or meeting with all appropriate parties.

#### Organizers

6. Request information about the chartering process from the LIC staff in the appropriate district office if it has not been requested previously. If information was previously requested, skips to step 10.

#### Licensing Staff

7. Discusses with the organizing group the application process and answers pertinent questions. For further detail, refers the organizing group to applicable booklets of the manual for guidance, if not previously provided.
8. Forwards information as requested about the chartering process to the organizers.
9. Decides whether to waive a prefiling meeting with the organizing group, if the group requested a waiver.



## Prefiling Meeting

### Contact Person

10. Requests that a prefiling meeting be scheduled.

### Licensing Staff

11. Schedules a prefiling meeting with the organizing group to review the requirements and procedures for organizing a national bank.
  - Invites the appropriate district supervisory, legal, and FDIC staff to participate in the prefiling meeting.
  - Sends a copy of any written material to the appropriate district supervisory, legal, FDIC staff, and, if appropriate, HQ LIC for review prior to the meeting.
12. Conducts the prefiling meeting and discusses the following subjects, as appropriate, with the group:
  - The OCC's role and, as applicable, that of the FDIC and the Federal Reserve.
  - The OCC's licensing and supervisory interactions for filings.
  - The key policies and specific requirements affecting the chartering process, including:
    - The OCC's policies to approve only a proposal with a strong management team and business plan.
    - The OCC's requirement of full disclosure by insiders and advance discussion of background investigation issues that may be problematic.
    - Capital, funding and liquidity, management selection, CRA plan, Internet technology, and vendor selection.
    - Plans to raise capital.
    - The importance of a comprehensive, well-developed business plan, including the markets the proposed bank will serve, the products and services to be offered, and the risk management systems that will be used to identify and control the attendant risks.
    - The OCC's significant change standard requirement that will be applied to the bank prior to opening and the significant deviation condition that will apply to the bank after opening (see Significant Changes discussion in this booklet and significant deviation discussion in Appendix G).

- The OCC’s ability to specify certain requirements that must be met before opening and to impose conditions in writing in addition to the significant deviation condition.
- If a BHC or non-BHC parent is organizing, discuss how it will be expected to provide liquidity support and how it should demonstrate that support.
- Whether the application qualifies for expedited versus standard review.
- How to file the charter application and follow the chartering procedures, including the time involved after submission.
- An overview of the organization phase.
- Common problems associated with new banks (see Avoiding Potential Problems discussion).

## Organizers

13. Provide information about:
  - How the group came together and the factors that led to the decision to file.
  - The organizers’ qualifications, both individually and collectively.
  - An overview of the proposal, including a discussion of the business plan and the market with particular emphasis on any unique aspects or novel policy or legal issues.

## Contact Person

14. [For bankers’ bank] If necessary, provides a written request and justification for waiver of certain legal requirements.

## Licensing Staff

15. Answers questions posed by those attending the meeting.
16. Contacts HQ LIC to decide if any pre-filing discussion or meetings revealed significant policy, legal, CRA, compliance, information technology, or supervisory issues:
  - Whether the application should be filed with HQ LIC, if broad issues are involved.
  - Whether specific issues should be carved out for HQ LIC action, while the application continues to be processed in the appropriate district office.

- When the filing should be forwarded to HQ LIC.
17. Ensures that specific issues are brought to the attention of the appropriate OCC staff if any prefiling discussion or meeting reveals significant policy, legal, compliance, or supervisory issues.
  18. Prepares a memo of the meeting and holds it in a pending file.
  19. Sends the summary memo to the appropriate supervisory office if no supervisory representative attended the prefiling meeting.
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## Procedures: Capitalizing the Bank

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***These procedures do not apply to banks that will be owned and capitalized by a BHC. These banks should contact the appropriate Federal Reserve Bank regarding capital issues. Banks capitalized through a BHC should provide such information in their application.***

### Organizing Directors

1. Take appropriate action to capitalize the bank and comply with the requirements of 12 CFR 16. Submit one original and three copies of the securities registration statement (registration statement), along with a completed application.
2. [Not applicable for holding company stock solicitation efforts.] Perform the following stock solicitation actions:
  - Designate an unrelated insured depository institution as escrow agent of stock subscription funds according to 12 CFR 16.31. Send a copy of the depository agreement to the OCC.
  - Advise the escrow agent that the funds may be invested **only** in United States government securities, including a mutual fund consisting exclusively of such securities.
  - Authorize the solicitation of stock subscriptions, including setting the price at which stock will be sold.
  - Authorize the preparation and filing of a registration statement with the appropriate district office (see CFR 16.15 for required information).

### Contact Person

3. Forwards to the OCC the original and three copies of the registration statement.

### Licensing Staff

4. Upon receipt of the registration statement, delivers the original to Communications and two copies to the District Counsel for a determination as to whether or not the material can be declared effective.
5. If the charter application was filed with the registration statement, within five business days of receipt:

- Reviews the application using the Charter Application Checklist to determine a completed application.
- Advises District Counsel if the application is deemed completed.

## District Counsel

6. Reviews the registration statement.
7. Requests corrections, if necessary.

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## Contact Person

8. Submits corrections to the application or the registration statement for review by the OCC.

## District Counsel

9. Generally, within five business days of notification from the Licensing staff that the application is deemed completed, declares the offering or registration statement effective. Initially advises the contact person by phone or email. Then, provides written confirmation that the registration statement is effective, generally within 10 business days after receipt.

## Organizing Directors

10. Before soliciting stock, verify that:
  - The OCC has reviewed the registration statement and declared it to be effective.
  - The escrow agent or the body corporate has sufficient liability coverage.
11. Solicit stock by providing each prospective shareholder with the registration statement prospectus, Subscription Offer, and any other information required under 12 CFR 16.
12. Instruct each prospective subscriber, verbally and through the registration statement prospectus, to send subscription funds directly to the escrow agent identified in the subscription letter. On an isolated basis, deposit funds inadvertently collected by the organizing bank with the escrow agent. (The escrow agent must have no association with the organizers or organizing directors.)

## Escrow Agent

13. Invests escrow funds received from subscribers directly in United States government securities, such as bills, bonds, and notes or in a mutual fund consisting solely of those securities. (Repurchase agreements are not considered direct deposits and cannot be used as escrow funds.)

## Organizing Directors

14. If the stock is fully subscribed during the offering period, go to step 22.
15. If the period for offering the registration statement expires prior to the sale of all shares of stock, cease soliciting stock and request an extension from the Licensing staff. The organizing directors may request an extension before the statement expires if it appears likely to expire before the stock will be subscribed fully.

## Licensing Staff

16. If the offering period has expired and the applicant requires an extension, reviews the extension request, makes a decision, and notifies the contact person. Decisions should be conveyed in writing from legal and a copy of the extension approval document sent to Communications.

## Organizing Directors

17. If the original registration statement disclosed a contemplated extension to the original offering period, file a prospectus supplement with the OCC. If the original registration statement did not disclose a contemplated extension to the original offering period, file a post-effective amendment to the registration statement, which the OCC must declare effective. (If a post-effective amendment to the registration statement is required, the organizers may be required to offer rescission rights to existing subscribers.)

## OCC Legal Staff

18. Reviews revised prospectus supplement or post-effective amendment, identifies and attempts to resolve any issues or concerns, declares the post-effective amendment effective, and notifies the contact person.

## Organizing Directors

19. If the extension is approved through a prospectus supplement, deliver a copy of the prospectus supplement to all existing subscribers and add the prospectus supplement to the prospectus, prior to the continuation of offers of sales.
  20. If the extension requires a post-effective amendment to be filed, once the amendment is declared effective, deliver a copy of the post-effective amendment to all existing subscribers and incorporate it into the offering materials.
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21. Continue with subscription efforts.
  22. Prepare and retain at the bank a shareholders' list that conforms to the requirements of 12 USC 63.

## Escrow Agent

23. Sends certification letter for capital funds to the CEO.

## CEO

24. Sends a copy of the certification letter for capital funds from the escrow agent to the OCC.

## Licensing Staff

25. Notifies the escrow agent to release funds.

## Escrow Agent

26. After receiving authorization from the OCC to disburse the funds, takes one of the following actions:
  - Returns funds to subscribers, if preliminary conditional approval has been revoked.
  - Releases funds to the bank (approximately two-to-three business days before the scheduled opening date).

### Filing the Application and Publication

#### Organizers

1. Submit a complete application, including the Interagency Biographical and Financial Reports, to the director for district licensing in the appropriate district office or to Headquarters Licensing (HQ LIC).
2. Publish a notice on the date of filing or as soon as practicable before or after the date of filing (see the "Public Notice and Comments" booklet).

#### Initial Review

#### Licensing Staff

3. Initiates and enters information into the Corporate Activities Information System (CAIS).
4. Establishes the official file to maintain all original documents and initiates background checks, as appropriate (see the "Background Investigations" booklet for procedures).
5. For all applications, sends the applicant an Acknowledgement of Receipt within five business days of receipt.
6. If the application is submitted by a sponsor, determines if the sponsor's lead depository institution meets the necessary criteria and is eligible for expedited review of the application; and
  - If the lead depository institution is not an eligible bank, prepares and sends a letter to the contact person providing notice of standard review within five business days of receipt.
  - (If appropriate) If the lead depository institution is an eligible bank, acknowledges (see the Acknowledgement of Receipt in the "General Policies and Procedures" booklet's OCC samples) filing within five business days of receipt.
7. Reviews the application, relevant information about proposed affiliates and ownership, and biographical and financial information (see the "Background Investigations" booklet) filed to determine if the filing contains all information necessary to reach a decision. If not, requests information from the contact person to be provided by a specific due date.
8. Within five business days of receipt, after reviewing the filing, notifies the appropriate assistant deputy comptroller (ADC) and ADC analyst or large



bank examiner-in-charge (EIC) (hereafter referred to as supervisory office) of receipt and requests that a field investigation be scheduled as soon as practical. At the same time, forwards a copy of the filing to appropriate OCC staff, including the appropriate supervisory office and OCC expert staff (such as Credit Risk and Treasury and Market Risk), along with a brief summary of the application, business plan, and the organizers. Solicits preliminary comments from OCC staff within 15 business days of receipt by staff.

9. If the filing does not contain all information needed by the OCC, including the appropriate supervisory office and OCC expert staff, to reach a decision, requests necessary information in writing and establishes a specific due date to provide the information. E-mails a copy of the request for additional information to the appropriate supervisory office, and other appropriate OCC staff.
10. Contacts HQ LIC if the proposal will affect significantly the quality of the environment or affect any district, site, building, or structure listed in, or eligible for listing in, the *National Register of Historic Places* (see the "General Policies and Procedures" booklet).
11. For bankers' banks, routes a request for an exemption or waiver from statutes or regulations to the Law Department.

## Field Investigation

12. Requests a field investigation from the appropriate supervisory office and solicits its input to determine the scope of the investigation.
13. Provides the national bank examiner (examiner) documents to assist him or her in conducting the field investigation and outlines the tailored scope of the investigation.

## National Bank Examiner

14. Contacts the contact person to arrange for the investigation.
15. Coordinates the investigation with the FDIC when possible.
16. Reviews documents, interviews insiders and other identified persons, and explores matters related to the proposed bank's operations consistent with the scope tailored for the proposed bank by Licensing (LIC) staff with input from other OCC staff.
17. Meets with the organizing group and proposed management to summarize the field investigation and its importance, discusses any significant issues, and communicates the investigation findings without offering a preliminary opinion about the likely decision on the charter application.
18. Prepares investigation findings, submits report for supervisory office approval, and forwards the completed report to LIC staff.

## Licensing Staff

19. Receives and reviews the field investigation report. Circulates copies to appropriate OCC staff.

## Public Comments and Hearings

20. If the public or interested persons request copies of the application, follows the Information Request Procedures in the "General Policies and Procedures" booklet.
21. If public comments are filed or a hearing is requested, refers to the "Public Notice and Comments" booklet for guidance and procedures.
22. Determines whether the comments are material.

## Review and Decision

23. **[For applications accorded expedited treatment only]** After the close of the public comment period, determines whether the filing should be disqualified from expedited review, and if:
  - No, continues processing.
  - Yes, immediately notifies the contact person that the proposed bank no longer qualifies for expedited review and identifies the specific reason.
24. Requests the appropriate supervisory office to sign off on supervisory office comments, including any examination and investigation reports. Copies the ADC analyst or large bank EIC on all such requests.

## Supervisory Office

25. **[For established BHC applications only.]** Consults with the appropriate supervisory office staff of the BHC or affiliated banks.

## Licensing Staff

26. Consults with HQ LIC if significant or novel policy, legal, supervision, or compliance issues have been identified. Considers options in steps 31 and 32.
27. Prepares confidential memorandum and decision letter recommending a decision to the delegated official.
28. Sends a copy of the confidential memo and draft decision letter to the appropriate supervisory office, if appropriate. Solicits final comments.

## Supervisory Office

29. Communicates with the supervisory office of the bank. Responds to Licensing staff within five business days.

## Licensing Staff

30. Solicits signoff from appropriate deputy comptroller. Provides a copy of the confidential memo, draft decision letter, and supervisory office comments to the deputy comptroller.

## Director for District Licensing

31. Takes one of the following actions:
  - Decides application under delegated authority if it is eligible for expedited processing or the director for district licensing and deputy comptroller concur on the outcome. Skips to step 33.
  - Forwards the official file to HQ LIC if the director for district licensing and deputy comptroller's recommendations differ or if the decision is not delegated to the director for district licensing. If forwarded to HQ LIC, skips to step 39.
  - Recommends denial and consults with LICA.
32. Contacts organizers, conveying the district's recommendation for denial, statutory factors supporting denial, and outlining options for organizers' consideration. If the application is withdrawn, makes CAIS entries, closes the file and forwards to Central Records. If the organizers want to proceed with the proposal, goes to step 27.

## Licensing Staff

33. Notifies contact person, interested parties, and appropriate supervisory office of decision.
34. Sends the contact person a decision letter.
35. Makes CAIS entries.
36. Informs contact person that the bank will not be allowed to open until all substantive matters, including risk management concerns, have been addressed.
37. Makes entry for all conditions imposed in writing under 12 USC 1818 (including the significant deviation condition) in the "Enforcement Actions" section of the OCC's electronic information system as Type "Regulatory Condition in Writing."

38. Places a copy of the signed and an electronic copy of the preliminary conditional approval letter into the appropriate folder for retrieval by the secretary to the Director for Licensing Activities (for publication). Maintains official file for additional processing during the organization phase.

## HQ LIC

39. Makes CAIS entries.
40. Reviews the file and all relevant information; solicits comments from other OCC divisions, as appropriate. If applicable, resolves differing recommendations between the deputy comptroller and the director for district licensing. Makes a recommendation.
41. Forwards the decision package with recommendation to the Director for Licensing Activities. Forwards to the decision maker.
42. Notifies the contact person, interested parties, the appropriate supervisory office, and director for district licensing of the decision.
43. Places a copy of the signed and an electronic copy of the preliminary conditional approval letter into the appropriate folder for retrieval by the secretary to the Director for Licensing Activities (for publication).
44. Makes CAIS entries. If denied, skips to step 48.
45. Makes entry for all conditions imposed in writing (including the significant deviation condition) in the "Enforcement Actions" section of the OCC's electronic information system as Type "Regulatory Condition in Writing."
46. Returns the official file to the director for district licensing or district licensing staff in the appropriate district office for additional processing during the organization phase.

## Organizers

47. Proceed to organize the bank (see the Organization Phase Procedures in this booklet).

## Close Out

### HQ LIC

48. Makes CAIS entries if appropriate, and forwards the official file to Central Records or returns the file to district licensing staff.

## Procedure: Organization Phase

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### Organizing the Bank

#### Organizers

1. Within 30 days after receiving preliminary conditional approval:
  - Establish process for maintaining minutes of all meetings of the organizers and organizing board at the bank's corporate headquarters.
  - At the first meeting of organizers or by unanimous written consent:
    - Execute Articles of Association and Organization Certificate and submit an original of each to the appropriate district office for processing by Licensing (LIC) staff, if not done earlier.
    - Fix the number of organizing directors to serve until the first meeting of the shareholders.
    - Elect as organizing directors the persons who have been cleared by the OCC, including the chief executive officer (CEO).
    - Review and document in the minutes the OCC's preliminary conditional approval letter and all other correspondence from the OCC.
    - Designate the organizing chairperson, secretary, or CEO as the person to initiate and receive all future correspondence from the OCC. If different than the contact person during the pre-decision phase of the application, advise the OCC of the new designee.
2. Advise the LIC staff of significant changes at any time during the organization phase.

#### Licensing Staff

3. Makes necessary Corporate Activities Information System (CAIS) entries throughout the organization of the bank.
4. If not submitted earlier in the application process, reviews Articles of Association and Organization Certificate for compliance with legal and policy requirements, and:
  - If any deficiencies are found, contacts the contact person and requests corrections.
  - When all requirements have been met, sends Acknowledgement of Articles of Association and Organization Certificate Letter and a copy of each document to the contact person.

- Places originals of the Articles of Association and the Organization Certificate in the OCC's charter application file.
5. Monitors organizing efforts including:
    - Capital raising efforts.
    - Significant changes in management, the business plan, or organization activities.
  6. Evaluates or identifies any potential significant change at any time during the organization phase, and:
    - Notifies Headquarters Licensing (HQ LIC) and the appropriate supervisory office about any significant changes made during the organization phase.
    - Allows organization to continue if the Licensing staff, in cooperation with other OCC staff, determines that the change is not significant, does not affect the proposal negatively, or otherwise does not warrant a change in the conditions imposed in the preliminary conditional approval letter.
    - Allows the group to alter or withdraw the proposed change if the Licensing staff, in cooperation with other OCC staff, determines that it is significant and would adversely affect the proposal.
    - Prepares a recommendation and forwards it to HQ LIC for final evaluation of the significant change if the Licensing staff determines that the proposed change is significant, has occurred already, and affects the proposal adversely.

## HQ LIC

7. Takes one of the following actions on any significant change:
  - Allows the organization to continue after review and nonobjection.
  - Revises the preliminary conditional approval letter to impose additional conditions and communicates conditions to the organizing group.
  - Revokes preliminary conditional approval and advises Licensing staff to have escrow agent return funds to subscribers if capital has been, or is in the process of being, subscribed. Then skips to step 38.
8. Notifies the Licensing staff, other OCC staff, and the organizing group of the decision and makes CAIS entries.

## Organizing Directors

9. Hold the organizing board's first meeting. Reflect in the minutes discussion of each of the following items:
  - Execute Joint Oath of Bank Directors. (See Instructions.) Execute an individual Oath of the Bank Director later, if necessary.
  - Authorize, at a minimum, the organizing chairperson and the organizing secretary to the board to sign checks and other documents.
  - Adopt a corporate seal.
  - Adopt a stock certificate form containing all information required by 12 USC 52. The par value of the stock should **not** appear on the face of the certificate, since par value is subject to change throughout the life of the bank.
  - Adopt bylaws.
  - Authorize the purchase of adequate insurance, including fidelity bond insurance.
  - Approve the specific location of the bank's office(s) and advise the OCC of any change in location from the one(s) identified in the charter application. The OCC may construe a change in location as a "significant change" and, if the organization is permitted to proceed, may necessitate republication and changes in the proposed bank's business plan.
  - Approve organization costs consistent with the OCC's organization costs guidance. Attach to the minutes a copy of approved organization costs.
  - Review 12 USC 1972 on the use of interbank deposits as compensating balances for loans to persons connected with the depositing bank.
  - Adopt a written insider policy that conforms to the guidelines in the "Insider Activities" booklet of the *Comptroller's Handbook*.
  - Adopt appropriate written policies pertaining to other areas of bank operations (see Minimum Policies and Procedures).
  - Establish an internal control system to ensure ongoing compliance with the currency reporting and record keeping requirements of the Bank Secrecy Act. Refer to Appendix F and the "Bank Secrecy Act" booklet of the *Comptroller's Handbook for Compliance* for details. [Not applicable to bankers' banks.]
  - Apprise directors of legal requirements that affect purchases from and sales to directors (12 USC 375); loans to executive officers, directors,

and principal shareholders of member banks (12 USC 375a, 375b, and 12 CFR 215); and correspondent accounts (12 USC 1972).

## Establishing Management and Site

*Steps 10 through 17 normally are not applicable for established BHCs that are accorded expedited review.*

10. Meet at least monthly as a group with the CEO and others, as needed, to oversee the organization of the bank.
11. Select remaining management officials and other insiders, including but not limited to a cashier or chief financial officer, a compliance officer, and a security officer. Submit to the OCC materials on each proposed management official, including the Interagency Biographical and Financial Reports and the director's investigative findings. Also submit appropriate biographical and financial information on newly identified directors and principal shareholders (see the "Background Investigations" booklet), sending appropriate documentation to Licensing staff for prior review.
12. Thoroughly investigate background and qualifications of each proposed executive officer, using criteria no less stringent than those detailed in the Management Review Guidelines of "Background Investigations."

## Contact person

13. Submits to the OCC materials on proposed management officials, including the Interagency Biographical and Financial Report from the "Background Investigations" booklet and the organizing group's investigative findings on each. Also submits appropriate biographical and financial information on newly identified directors and principal shareholders.
14. [For bankers' banks only] Submits to the OCC financial reports on newly identified banks that would like to participate in the bankers' bank that are consistent with those submitted by the organizing banks.

## Licensing Staff

15. Provides the supervisory office with a copy of materials on any newly proposed management officials, identified directors, and principal shareholders (insiders). Requests their reviews and recommendations as part of the review process.
16. Within 30 calendar days after receipt of materials for each proposed executive officer, director, or principal shareholder, communicates any concerns to the proposed insider. Furthermore, notifies the organizing group by telephone and by letter through the contact person whether the OCC:
  - Has no objection to the proposed insider.
  - Needs more time to perform its background investigation of the proposed insider.



- Desires to conduct a personal interview with the proposed insider.
  - If a personal interview is conducted, includes the supervisory office in the interview process and documents the meeting for the file.
17. If the OCC identifies concerns with the proposed insider, performs the following steps, otherwise, skips to step 18:

For adverse information considered minor in nature, notifies the person of the reason for the OCC's initial concerns and allows the person to respond to the concerns prior to the OCC making a decision.

- For adverse information considered substantive in nature, notifies the person by registered or certified mail of the basis for the OCC's concerns and allows the person to complete, correct, or challenge the adverse information prior to the OCC making a decision.
- After considering any response from the person or organizers, the OCC may request by registered or certified mail additional information to follow up a response prior to making a decision.
- At its discretion, the OCC may interview the person or other persons to gather additional information.

Depending on the nature of the adverse information, encourages the proposed insider to discuss with the organizers (through the contact person) the basis for the OCC's concerns and invite submission of additional information from the organizing directors.

After appropriate due process, prepares and forwards a recommendation and a draft objection letter to HQ LIC for decision.

18. Decides the recommendation for the management official and, for objections, sends an Objection Letter to the person and the organizing directors through the contact person. The OCC will omit any confidential or sensitive information about the person in its letter to the contact person.

## Organizing Directors

19. Review and document in the minutes of the board:
- Any transactions with insiders. Include the following information for each transaction:
    - Name and address of owner of property or provider of service.
    - Relationship to the bank.
    - Asset or service to be acquired.
    - Date the current owner acquired the property, if applicable.

- Cost of property to current owner or estimate of the cost of services, if applicable.
  - An independent appraisal of any property acquired or an independent evaluation of lease terms.
  - Any other relevant information that demonstrates the proposed transaction is fair, reasonable, and comparable with similar arrangements that could have been made with unrelated parties.
  - A board resolution approving the specific details in advance of the transaction.
- 
- If the site of the bank's building will have an adverse effect on a historical property as identified by the State's Historic Preservation Office, pursue receipt of a letter from the state that eliminates or resolves the concern. (See the National Historic Preservation Act discussion in the "General Policies and Procedures" booklet.)
  - The lease or purchase agreement for all bank premises.

## Meeting of Shareholders and Directors

20. Mail the Notice of First Shareholders' Meeting and Proxy Statement to shareholders at least 10 calendar days before the scheduled shareholders' meeting. Submit a copy of each document to the Licensing staff.

## Shareholders

21. Conduct business that properly may arise and document those activities, including the following actions, in the minutes of the first shareholders' meeting:
  - Fix the number of directors.
  - Elect to the board of directors those persons approved by the OCC and identified in the registration statement.
  - Approve an itemized list of organization costs that should be attached to the minutes, and additional expenses, accrued but not paid, that will be paid or reimbursed from capital funds.
  - Ratify the Articles of Association, Organization Certificate, and all official acts of the organizers, organizing directors, and officers since the organization of the association.

## Directors

22. Hold the organization meeting. Document the following accomplishments, at a minimum, in the minutes of the first meeting of directors:
  - Complete a Waiver of Notice of the First Board Meeting.
  - Execute the Oath of Bank Director or Joint Oath of Bank Directors.
  - Elect the chairman, secretary, and other officers of the board and appoint the president, CEO, cashier, and other executives.
  - Certify and execute the Capital Stock Payment Certificate.
  - Ratify the bylaws.
  - Elect standing committees as set out in the bylaws.
  - Select a depository bank.
  - Authorize the CEO (or another person) to maintain contact with the FDIC about the status of the bank's deposit insurance application, if the bank will be insured.

## Organizing Bank Operations

### CEO

23. Orders the forms and establishes the operating, risk management, and control systems needed to conduct banking business.
24. Advises the OCC if there has been a change in location (for example, a specific location for a "vicinity of" location), since the OCC granted preliminary conditional approval to the application.

### Licensing Staff

25. Determines whether a change in location constitutes a significant change.

## Preopening Examination (POE)

### CEO

26. At least 60 calendar days before the proposed opening date, submits an Organization Completed letter to Licensing staff and requests the POE, indicating readiness for opening.

## Licensing Staff

27. Upon receipt of the Organization Completed letter, requests a national bank examiner to conduct the POE at least 14 calendar days prior to the proposed bank opening date. LIC determines the scope of the POE with input from the appropriate supervisory office.
28. Places oaths in the bank's charter file and retains for 10 years consistent with the requirement in 12 USC 73.

## National Bank Examiner

29. Contacts the CEO to arrange for the POE.
30. Coordinates with other units and the FDIC, if needed.
31. Conducts the POE. Determines whether all substantive issues, including risk management concerns, have been addressed adequately. Discusses POE findings with Licensing staff.
32. Meets with management and the board of directors at the conclusion of the visit to inform them of the POE findings, but does not convey a recommendation about the final approval for the bank's opening.
33. Prepares the POE report.

## Licensing Staff

34. Reviews the POE report and takes one of the following actions:
  - Notifies the bank that it may not open, until certain specific outstanding matters, including any remaining risk management and other concerns, have been resolved.
  - Prepares a memorandum to discuss issues that the OCC should impose as additional conditions to the preliminary conditional approval.
  - Prepares a memorandum to discuss significant adverse factors and recommends to HQ LIC that the bank's preliminary conditional approval be revoked.
  - Notifies the bank that it may open subject to completion of step 38.

## HQ LIC

35. If LIC staff recommends revocation or additional conditions, takes one of the following actions:

- Imposes additional conditions to the preliminary conditional approval of the charter and allows bank to open subject to completion of step 38.
- Revokes preliminary conditional approval and advises Licensing staff to have escrow agent return funds to subscribers.
- Directs Licensing staff to permit the bank to open subject to completion of step 38.

## **Continuing to Organize Bank Operations**

### **CEO**

36. Requests from the Federal Reserve application forms for membership.
37. Submits application forms for membership to the appropriate Federal Reserve Bank governing the bank at least four weeks prior to the projected opening date.

## **Chartering and Commencing Business**

38. Takes the following actions, as needed:
  - Resolves outstanding matters and advises Licensing staff members.
  - Continues with opening preparations, including:
    - Confirms receipt of final deposit insurance approval from the FDIC, if the bank will be insured.
    - Confirms receipt of bank membership in the Federal Reserve System.
    - Notifies the OCC and other federal regulators of any opening date delay, if appropriate.
    - Requests certification letter for capital funds from the escrow agent.

### **Contact Person**

39. Confirms the bank's opening date with the OCC one business day prior to opening.

### **Licensing Staff**

40. Verifies receipt of Capital Stock Payment Certificate.
41. Notifies the bank that it may open and sends final approval.

## CEO

42. On the opening day:
  - Notifies Licensing staff members that the bank has opened.
  - Issues stock certificates to the stockholders.
  - Pays or capitalizes organizing expenses, including bank premises, that are approved by the shareholders, consistent with generally accepted accounting principles (GAAP) accounting treatment, and not objected to by the OCC.

## Licensing Staff

43. On the opening day, notifies the appropriate supervisory office and other OCC staff that the bank has opened.

## Close Out

44. Makes CAIS entries.
45. Completes the Charter Handoff Checklist and, as appropriate, provides copies to the supervisory office of the remaining information listed in the New Bank Handoff Package and other pertinent facts.
46. Forwards the Charter Certificate to the bank. Files two copies of the bank's Charter Certificate in the OCC's charter file.
47. Forwards all original documents to Central Records after reviewing the files for completeness.
48. Updates the OCC's electronic information system with the effective date for all conditions imposed in writing under 12 USC 1818 (including the significant deviation condition) in the "Enforcement Actions" section of the OCC's electronic information system as Type "Regulatory Condition in Writing."

## Appendix A: Parallel-Owned Banking Organizations

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### **Possible Representations or Commitments for Charter Applications Resulting in a Parallel-Owned Banking Organization**

Concerns for the national bank that arise from a parallel-owned banking organization typically result in expanded assurances regarding the bank's operations (see previous discussion in Parallel-owned Banking Organizations section). The following are examples that the OCC may require to facilitate the supervision of parallel-owned banking organizations:

1. Establishing party agrees to provide all information, without regard to whether such information is located within or outside the United States, when requested, relating to:
  - (a) Enforcement or possible enforcement of, or any proceeding under, any United States law;
  - (b) The direct or indirect ownership or control of the bank [bank holding company, if appropriate]; and
  - (c) The operations or activities of the bank [bank holding company (BHC), if appropriate], or any institution-affiliated parties (IAP) regarding each thereof under United States law, including any unsafe or unsound practice or breach of fiduciary duty by the bank [BHC, if appropriate], or by any IAP with respect to each thereof.
2. Establishing party agrees to provide the OCC and its staff access to, to permit the OCC and its staff to examine, and to provide the OCC and its staff with copies of, all books and records; access to electronic records that accurately reflect the information in the books and records; and any other information, of or concerning the bank, as requested by the OCC or its staff, without regard to whether such books and records or other information are located within or outside the United States.
3. Based on the opinions of counsels in the foreign jurisdictions where each establishing party is a citizen, and where each party resides, each party understands and represents that there are no statutory or regulatory requirements of, or judicial interpretations in, these jurisdictions that would preclude or limit examination in such jurisdictions, or use in the United States, of the books and records of applicant by the OCC and its staff. In addition, based on these opinions of counsels, each establishing party understands and represents that there are no statutory or regulatory requirements of, or judicial interpretations in, these jurisdictions that otherwise would limit the ability of the parties to comply fully with commitments and representations 1 and 2 above, except to the extent that waivers of confidentiality by establishing persons would be necessary to permit such examination or use of establishing persons' books and records, which waivers persons hereby grant and agree to grant on a continuing basis. Each establishing person understands and represents that there are no

statutory or regulatory requirements of any jurisdiction that preclude, limit, or make ineffective, in whole or in part, any waiver of confidentiality as described in this commitment or representation.

4. Each establishing person consents and submits to the personal jurisdiction of any United States federal court of competent jurisdiction and of any federal banking authority for purposes of any investigation or possible investigation, action, subpoena, examination, or proceeding by any federal banking authority, the United States Department of Justice, or the United States Department of the Treasury, relating to the administration or enforcement of any United States law or pursuant to any United States law, including, in particular, section 8 of the Federal Deposit Insurance Act. For purposes of this commitment or representation, each establishing person shall, at all times, maintain in the United States a designated agent, acceptable to the OCC, to accept service on the acquiring person's behalf, including service of any process, notice, order, or subpoena. Each establishing person, as of the date hereof, designates [name of agent], located at [address, city, and state], as his or her agent to accept such service. An establishing person will not change this designation without notice to, and consent of, the OCC or its staff.
5. Each establishing person agrees to submit the following documents to the OCC prior to the OCC's consideration of the proposal in connection with which these commitments or representations are submitted:
  - (a) A notarized and authenticated or certified document, designating the agent(s) specified in commitment or representation (No. 4 above) to accept service on behalf of each establishing person;
  - (b) An opinion of independent counsel in the jurisdiction where applicant is a citizen and, if different, where applicant resides:
    - (i) that each of the commitments or representations is enforceable under the laws of the relevant jurisdiction, and (ii) that there are no statutory or regulatory requirements of, or judicial interpretations in, the relevant jurisdiction that would limit the ability of the applicant to comply fully with commitments or representations 1 and 2 above, subject to the need for a waiver of confidentiality as provided in commitment or representation (No. 3 above), or that would preclude, limit, or make ineffective, in whole or in part, any such waiver of confidentiality that is granted; and
  - (c) Properly executed written documentation to effect a full waiver of confidentiality under the law of the relevant jurisdiction, as provided in commitment or representation (No. 3 above).
6. No later than the time of consummation of the transaction, each establishing person will provide to the bank a list of his or her "related interests" (as defined in section 215.2 of Regulation O, 12 CFR 215.2) and a list of the bank's affiliates (as defined in 12 USC 371c(b)(1) and Regulation W, 12 CFR 223.2) to be maintained by the bank. Each establishing person will update these lists annually or more frequently as changes occur in "related interests" or affiliates. Each establishing party and each company that from time to time is controlled directly or indirectly by any establishing party, acting alone or in concert with one or more other persons, will be deemed to be "insiders" of



the bank in all dealings with the bank for purposes of Regulation O (12 CFR 215).

7. [NOTE: The OCC will require one of the following commitments or representations or a similar commitment or representation after considering such factors as the adequacy of foreign supervision; the ability and willingness of the foreign supervisors to cooperate and share information cross-border, and the condition of the bank and foreign bank.]
  - (a) There will be no transactions between the Bank and foreign affiliates.
  - (b) There will be no covered transactions under 12 USC 371c or 371c-1, or Regulation W, 12 CFR 223, between Bank and foreign affiliates.
  - (c) Each establishing person commits or represents that dealings between the bank and any company that is an "affiliate" of the bank, which may include certain companies in which applicant holds an interest, will be subject to the restrictions in 12 USC 371c and 371c-1, as implemented by Regulation W. For purposes of this commitment or representation, an extension of credit also includes a deposit by the bank with an affiliate.
8. Each establishing person and the bank commit or represent that they will notify the OCC if the bank engages in the following types of affiliate transactions: (1) transactions that will materially affect the bank's capital, (2) transactions that will materially affect the affiliate's financial position, and (3) any back-to-back loan transactions between the bank and any person (including affiliates) that benefit members of the organizing group.
9. Each establishing person or the bank will notify the OCC of any loan or deposit made by the bank to an affiliate that has deposited or loaned funds to the bank, provided the funding for the loan or deposit by the bank is directly or indirectly linked to the affiliate's funds on loan or deposit with the bank.
10. Each establishing person or the bank will notify the OCC of any increase in permanent capital when the capital funds invested were received from any person who has obtained a loan or a deposit from a bank or any affiliate, provided the funds for the increase in capital are directly or indirectly linked to the funds from the loan or deposit from the bank.
11. Each establishing person will notify the OCC of any loan received by a member of the organizing group from any person who has obtained a loan or a deposit from the bank, provided the funding for the organizing group loan is directly or indirectly linked to the funds from the loan or deposit from the bank.
12. While a charter application is pending, the establishing parties will promptly notify the OCC of any changes or pending changes in affiliation.
13. Each establishing person and the bank commit or represent that the bank will not engage directly in the international transfer, remittance, or payment of customer or bank funds except through an unaffiliated correspondent bank.

Approval of the OCC will be obtained before the bank begins to engage directly in the international transfer of funds.

*Alternatively:*

Each establishing person and the bank agree that the bank will not engage in the international transfer, remittance, or payment of customer or bank funds except in compliance with safe and sound formally adopted internal control procedures and operational safeguards, which shall include, in all cases, written documentation of all relevant information concerning each such transfer, remittance and payment, as adopted as a policy of the bank and in compliance with all laws, regulations, orders, and directives applicable to the bank and its officers, directors, and affiliates.

14. Each establishing person represents that the funds being used to establish the bank are not derived directly or indirectly from the foreign bank or its affiliates, except to the extent that these funds are derived from usual profits and dividends from the foreign bank or its affiliates obtained over the years.
15. Neither an establishing person nor the bank will incur any additional debt (other than small amounts incurred in the ordinary course of business) to any third party without the prior approval of the OCC.
16. None of the capital stock or debt of the bank will be transferred or pledged to any third party without the prior approval of the OCC.
17. Each establishing person commits that the bank will maintain total risk-based capital ratios so that the bank is, at all times, considered well-capitalized under 12 CFR 6.

## Appendix B: Directors' Duties and Responsibilities, Qualifications, and Other Issues

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The Comptroller of the Currency expects each director to be familiar with the statutory responsibilities associated with that position. The board of directors of a national bank may not delegate responsibility for its duties, but may entrust the day-to-day bank operation to bank management. Directors can refer to OCC publications specifically addressing director responsibilities (refer to *The National Bank Director's Handbook* and the "Duties and Responsibilities of Directors" booklet of the *Comptroller's Handbook*).

### Duties and Responsibilities of Directors

A national bank, as other corporate organizations, has shareholders who elect a board of directors. A bank's board of directors oversees the management of the bank's activities. Directors must exercise reasonable care when guiding the bank's affairs.

Bank directors face unique challenges because banks differ from other corporations. Although banks, like other corporations, use their capital to support their activities, most of the funds banks put at risk belong to others, primarily depositors. Banks lend and invest customers' deposits to earn a profit and a reasonable return to shareholders and to meet the credit needs of the community. Properly managing risk to serve those interests is a critical challenge faced by the board and bank management.

As corporate board members, bank directors have duties to the banking corporations they serve. Those duties are known as the duties of diligence and loyalty.

The duty of diligence means that directors must devote the time and attention necessary to enhance safe, sound, and legal operations of the bank. Directors must attend directors' meetings, review meeting materials, and ask questions and seek explanations to understand the issues completely. They must use independent judgment and be objective when overseeing the bank's affairs. A director's decision-making process should involve careful consideration of reasonably available and relevant information. A director should abstain from discussing or voting on any transaction that the bank may consider undertaking with the director or any company or other related interest of that director as defined in Regulation O.

The duty of loyalty means that directors must never put their own or other competing interests above those of the bank they serve. The duty of loyalty requires directors to administer the affairs of the bank with candor, personal honesty, and integrity. Relationships with the bank must always be at arms-length. In addition, directors may not take business opportunities away from the bank inappropriately.

National banks and their directors are accountable, not only to their shareholders and depositors, but also to their regulators. The risks inherent in banking, the safety net provided by deposit insurance, and the importance of a safe and sound banking system to the nation's economy make this oversight appropriate.

Although a board of directors does not guarantee the bank's success, it must oversee bank operations to ensure that the bank conducts business in a safe and sound manner. The board must keep informed about the bank's operating environment; hire and retain competent management; and ensure that the bank has a risk management structure and process suitable for the bank's size and activities. The board also must oversee the bank's business performance and ensure that the bank serves the community's credit needs. Problems arising from failures in any of those areas represent the board's failure to exercise properly its oversight responsibilities and can result in individual liability if a director has not acted as a reasonably prudent director would act in similar circumstances.

To strengthen corporate governance, financial disclosures, and auditor independence, Congress passed the Sarbanes-Oxley Act of 2002 (Act). While many of the provisions of this Act will not be applicable to a newly chartered bank, directors and bank management should be familiar with the requirements of the Act. They should implement similar standards when appropriate based on the size, complexity, and risk tolerance of the bank.

Management works for the board of directors; the board of directors does not work for management. The long-term health of a bank depends on a strong, independent, and attentive board. A board should evaluate its effectiveness periodically and determine whether it is taking steps necessary to fulfill its responsibilities. The board also should consider orientation programs for new directors. Ongoing education programs that describe emerging industry developments, opportunities, and risks also are often helpful.

When searching for new bank directors, banks should seek persons who will exercise independent judgment and actively participate in decision making. The principal qualities of an effective bank director include strength of character, an inquiring and independent mind, practical wisdom, and sound judgment.

In summary, the qualifications of a candidate seeking to become a member of the board of directors of a national bank include:

- Basic knowledge of the banking industry, the financial regulatory system, and the laws and regulations that govern the operation of an institution.
- A willingness to put the interests of the bank ahead of personal interests.
- A willingness to avoid conflicts of interest.
- Knowledge of the communities served by the bank.
- Background, knowledge, and experience in business or other disciplines.
- A willingness and ability to commit the time necessary to prepare for and regularly attend board and committee meetings.

The primary responsibilities of the board of directors of a national bank include:

- *Being aware of the bank's operating environment.* Directors should understand generally both the bank's business environment and the legal and regulatory framework within which the bank's activities operate.
- *Hiring and retaining competent management.* A profitable and sound bank usually is the result of talented and capable management.
- *Maintaining an appropriate board structure.* The board should establish appropriate committees that have the responsibility of overseeing significant functions or activities within the bank, including the audit function, a loan review program, and a compliance review function.
- *Monitoring operations.* Although the board may depend on management's expertise to run the bank's daily operations, the board remains ultimately responsible for monitoring the operations of the bank.
- *Remaining independent.* The board must remain independent of undue influence of management and controlling owners.
- *Overseeing business performance.* Sound business performance is one of the board's primary objectives and responsibilities as well as a key indicator of management's success.
- *Serving community credit needs.* Every insured national bank is required to fulfill its responsibilities under the Community Reinvestment Act (CRA).

More information about the role of a bank director is available in *The Director's Book: The Role of the National Bank Director (The Director's Book)* and *Internal Controls, A Guide for Directors* (refer to [The National Bank Director's Toolkit](#)).

## Director Qualifications

Each national bank director must meet the qualification requirements found in 12 USC 72, unless a residency or citizenship waiver request is submitted to and approved by the OCC (see the "[Director Waivers](#)" booklet of the *Comptroller's Licensing Manual*). Specifically, each director must:

- Hold a minimum \$1,000 par value or fair market value of stock in his or her own right in the bank or an equivalent interest in the parent company that controls the national bank.
- Be a citizen of the United States throughout his or her term of service, except that the OCC may waive this requirement for a minority of the total number of directors.

At least a majority of the directors must have resided in the state, territory, or district in which the bank is located, or within 100 miles of the bank's location, for at least one year immediately preceding election as directors, unless the OCC grants a

residency waiver. The directors must continue to meet this requirement unless the OCC grants a residency waiver.

## **Election of Directors**

The bank's shareholders elect the directors at their annual meeting. National banks must have at least five directors and ordinarily no more than 25, but the OCC may waive the 25-member limit. Once directors meet the 12 USC 72 qualification requirements, they take the oath of office before a notary or other official authorized by state law. Under 12 USC 71, directors shall hold office for a period of not more than three years and until their successors have been elected and qualified. Directors may serve staggered terms if authorized by the bank's bylaws.

## **Vacancies on the Board**

Directors remaining on the board appoint a replacement if a vacancy occurs. The replacement must meet the director qualification requirements previously discussed. The newly appointed director serves until the next annual election of directors by the bank's shareholders.

## **Depository Institution Management Interlocks Act**

The Depository Institution Management Interlocks Act (Interlocks Act) generally prohibits a bank or BHC management official from simultaneously serving as a management official of an unaffiliated depository institution or depository institution holding company.

There are certain exemptions from these interlock prohibitions. Some management interlocks are exempted by statute and some qualify for exemption under the OCC's regulation without filing an application. Other interlocks may be exempted if the OCC approves a specific application. The OCC may exempt a prohibited management interlock if it determines that dual service would not result in a monopoly or substantial lessening of competition and would not present safety and soundness concerns.

OCC regulations provide for two broad categories of permissible exemptions: the Small Market Share Exemption and the General Exemption. The Small Market Share Exemption applies to depository organizations with limited control of an area's deposits. This exemption does not require an application or prior OCC approval. Under the General Exemption, the OCC may, through the application process, exempt a management official's service that the Interlocks Act otherwise would prohibit.

The OCC's regulations provide that in certain instances in which a general exemption is sought, the agency will apply a rebuttable presumption that an interlock will not result in a monopoly or substantial lessening of competition. Under the OCC's regulation governing the General Exemption, 12 CFR 26.6(b), these instances include a depository institution seeking to add a management official when it:

- Serves primarily low- or moderate-income areas.

- Is controlled or managed by members of a minority group or women.
- Has been chartered for less than two years.
- Is deemed to be in “troubled condition” by the OCC.

Organizers interested in establishing a management interlock should review the OCC’s Management Official Interlocks regulation before submitting a request for an interlock exemption. Organizers should include their request with their charter application. See the “Management Interlocks” booklet for more complete information.

## Potential Liability

Directors, officers, and employees may face personal liability in the performance of their duties and responsibilities as prescribed by banking laws and other regulations. A director can obtain some protection against large financial losses through indemnification agreements and liability insurance.

The bank may make or agree to make indemnification payments to an institution-affiliated party, as defined at 12 USC 1813(u), for damages and expenses, including the advancement of expenses and legal fees. This may occur in cases involving an administrative proceeding or civil action initiated by a federal banking agency **only** if such payments are reasonable and in accordance with 12 USC 1828(k) and the OCC’s and FDIC’s implementing regulations, 12 CFR 7.2014 and 12 CFR 359, respectively. For administrative proceedings or civil actions not initiated by a federal banking agency, such payments must be made in accordance with:

- The law of the state in which the main office of the bank is located.
- The law of the state in which the bank’s holding company is incorporated.
- The relevant provisions of the Model Business Corporation Act (1984, as amended 1994, and as amended thereafter), or Delaware General Corporation Law, Del. Code Ann. tit. 8 (1991, as amended 1994, and as amended thereafter).

Payments also must be consistent with safe and sound banking practices.

The OCC may review any indemnification payments made by the bank to evaluate whether they are consistent with safe and sound banking practices, standards adopted by the bank in its bylaws, and applicable laws and regulations.

Bank organizers should structure any proposed stock benefit plan to encourage the participants' continued involvement in the bank. The plan also should serve as an incentive for the successful, long-term operation of the bank.

Stock benefit plans should contain **no** feature that would:

- Encourage speculative or high-risk activities.
- Serve as an obstacle or otherwise impede the sale of additional stock to the general public.
- Be structured to convey control of a national bank or otherwise provide preferential treatment to the bank's insiders.

## Primary Types

In general, two primary types of stock benefit plan exist:

- Type 1 plans grant options or warrants to directors and active executive officers to reward future performance.
- Type 2 plans grant options or warrants to organizers and founders as compensation for:
  - Financial risk borne to fund the formation or organization of a bank (seed money).
  - Noncash contribution of assets (such as land for a banking facility) (see the "Capital and Dividends" booklet of the manual).
  - The guarantee of a loan to finance a bank's organization.
  - Professional services (for example, legal, accounting, or underwriting services) rendered to facilitate the establishment of the bank.

## Type 1 Plans

Banks typically use Type 1 plans to reward executive officers and directors for future performance. Accordingly, their continuing involvement to support successful operations of the bank after it opens is **required** for participation in Type 1 plans. The plan need not grant stock options to all executive officers or directors of the new bank, but the organizing group should provide support for the number of options made available to each plan participant.

In some new banks, CEOs and other key officers may receive stock options at the bank opening similar to "signing bonuses," which are intended to compensate them for financial risks they assume in joining a new bank's management team. Financial risks to senior executive officers can be twofold. First, they often leave positions in



established institutions that they may have held for extended periods. Second, these officers may find themselves subsequently unemployed for an extended period of time or need to take a lesser position in another institution if the new positions do not work out and they leave after a relatively short tenure. The OCC requires the terms of these stock option plans to conform to OCC policy guidelines. In addition, the OCC considers this form of compensation in its evaluation of overall compensation.

## Type 2 Plans

Organizers and founders may participate in Type 2 plans. Type 2 plans provide vehicles for organizing groups to reimburse organizers and founders for financial risk borne during the organization phase, such as providing seed money, contributing organization funds or noncash assets, or guaranteeing a loan. An organizer or founders could elect to receive as compensation either cash or stock or any combination of the two.

The number of shares received is determined by dividing the amount to be reimbursed by the value of each share. Organizers and founders may not receive stock options for additional stock subscribed that would exceed the amount for which they are being reimbursed. If stock options or warrants are received in exchange for an organizer's or founder's guarantee of a loan, each person's options or warrants should not exceed his or her pro rata amount of the loan guarantee or the amount drawn, if less than the guaranteed amount of the loan.

Professional services normally are paid for in cash. Professional service providers, however, may participate in Type 2 plans if the service provider lowers the cash payment for the service rendered to the organization as a result of plan participation.

If an organizer or founder, who is also a service provider, is fully reimbursed in cash for all professional services, he or she can participate in a Type 2 plan only if stock compensation is elected for reimbursement of seed money, organization funds, contributions of noncash assets, or loan guarantee.

## Type 1 and Type 2 Plan Requirements

Type 1 and 2 stock benefit plans must include:

- A limited duration of rights (maximum of 10 years).
- An exercise, or strike, price of stock rights, which shall be no less than the fair market value of the stock at the time that the rights are granted.
- A clause that allows the OCC to direct the bank to require plan participants to "exercise or forfeit" their stock rights if one of the following occurs:
  - Capital falls below regulatory minimums as set forth in 12 CFR 3, or a higher requirement as the OCC may determine.
  - The existence of outstanding warrants impairs the bank's ability to raise capital.

## Additional Type 1 Requirements

Type 1 stock benefit plans also must include the following requirements:

- A maximum of one option or warrant for each share subscribed or purchased in the initial offering (in other words, a “one for one” stock option or warrant plan).
- Vesting requirements that encourage the participant to remain involved in the bank’s operations (for example, vesting approximately equal percentages each year over the initial three years of operations).
- Restrictions on the transferability of the options or warrants, except transfer to a holder’s estate in the event of death or permanent disability.
- Rights upon termination of relationship with the bank.

### **Acceleration and Vesting of Unearned Options or Warrants**

The OCC permits acceleration and vesting of earned and unearned options or warrants if:

- The stock benefit plan required a three-year minimum vesting period, and
- The three-year period has elapsed.

The OCC permits immediate acceleration and vesting without regard to the previous criteria if an executive officer or director becomes permanently disabled or dies. The OCC requires an executive officer or director to forfeit unvested options or warrants under all other circumstances.

### **Rights of Termination**

An executive officer or director who ceases to be an active participant in the bank’s operations must exercise or forfeit options or warrants within 90 calendar days after separation from or termination by the bank. In the event of permanent disability or death, the stock option holder or the person’s estate should exercise options or warrants within 12 months or else forfeit the options.

## Additional Type 2 Requirements

Type 2 stock benefit plans, unlike Type 1 plans, do not require vesting, transferability restrictions, or continued association with the national bank. Type 2 stock compensation plans must meet the following additional plan requirements:

- A maximum of one option or warrant per share subscribed for the contribution of organization funds, noncash assets, or guaranty of a loan for the new bank.
- A maximum of one option or warrant per share subscribed for the payment of professional services.

## Management and Employee Stock Benefit Plans

In addition to Type 1 and Type 2 plans, the bank's board of directors may authorize a prospective management stock benefit plan (also called a stock incentive plan) for its executive officers or an employee stock option plan for its employees. In this context, the definition of executive officer is not confined to that included in Regulation O. Any insider who participates in a management stock incentive plan also would be considered an executive officer. Directors may participate in the plan as a method of payment for their services to the bank. In many cases, participation may be tied to specific individual or bank performance criteria.

Management and employee stock benefit plans should encourage the continued involvement of the participants and serve as an incentive for the successful, long-term operation of the bank. In addition, such plans should:

- Be viewed as part of a person's total compensation.
- Be reasonable, relative to the service provided.
- Include compliance with appropriate other laws, including applicable federal and state tax laws.

The bank should conform the terms of these plans to the requirements of Type 1 plans. Management and employee stock benefit plans, like other stock benefit plans, should not encourage speculative or high-risk activities or serve as an obstacle to, or otherwise impede, the sale of additional stock to the general public.

The exercise of rights granted by a stock benefit plan may trigger a filing to the OCC under the Change in Bank Control Act (CBCA) (12 USC 1817(j)) or the OCC's implementing regulation, 12 CFR 5.50. If an option holder's exercise of rights would trigger the prior notice requirements, the holder must fulfill the CBCA prior notice requirement before exercising the option.

## Accounting for Employee Stock Options

A national bank should account for employee stock compensation in accordance with generally accepted accounting principles (GAAP). Charter applicants should consider the effect of the Statement of Financial Accounting Standards Number 123 (Revised 2004): *Share-Based Payment* in developing stock benefit plans and financial projections. The accounting entries likely will result in an increase in permanent capital with an offsetting decrease to retained earnings (refer to the "Capital and Dividends" booklet for specific details when preparing the financial projections).

## Appendix B: Supervision and Oversight Highlights

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The Comptroller of the Currency (OCC) strives to deliver to all national banks the highest possible quality of bank supervision. Supervisory efforts are directed toward identifying material problems, or emerging problems, in individual banks or the banking system, and toward ensuring that such problems are corrected appropriately. Because banking is essentially a business of managing risk, supervision is centered on the accurate evaluation and management of risks. The OCC applies that philosophy in all supervision activities it conducts, which include safety and soundness, consumer compliance, information technology (IT), and asset management activities.

Clear and meaningful communication between the OCC and the banks it supervises is a vital component of high-quality supervision. To that end, the OCC publishes on its Web site examination procedures and guidance about evolving issues so that bankers are apprised of OCC examination and supervision activities. Further, the OCC believes that bankers, and not regulators, should manage their banks; as a result, it expects banks to establish and follow appropriate risk management practices.

### **The Evaluation Process**

The OCC determines the frequency of its onsite examinations (the supervisory cycle) based on the bank's size, complexity, risk profile, and condition. Full-scope onsite examinations normally are conducted either annually or up to every 18 months (12 CFR 4.6), but examination activities may be spread throughout the supervisory cycle.

Examiners meet with bank management and the bank's board of directors throughout the supervisory cycle to obtain information or discuss issues. At the completion of the cycle, the examiners prepare a report and conduct a meeting with the bank's board of directors to discuss the results. Those meetings allow participants to discuss the objectives of the OCC's supervision; strategic issues that may be confronting the bank; any major concerns, risks, or issues that may need to be addressed; and other matters of mutual interest. Directors review and sign the report of examination.

An environment in which examiners and board members openly and honestly communicate benefits a bank. OCC examiners and professional staff have experience with a broad range of banking activities and can provide independent, objective information on safe and sound banking principles and compliance with laws and regulations.

### **Risk Assessments**

The OCC recognizes that banking is a business of taking risk in order to earn profits. Risk levels, however, must be appropriately managed and controlled. Banking risks also must be evaluated in terms of their significance. These assessments should be ongoing.

The OCC's primary supervisory objective is to assess each bank's ability to identify, measure, monitor, and control risks through its risk management systems. The OCC

does this through its risk assessment systems, one tailored to community banks and another to large banks. The OCC has defined nine categories of risk for bank supervisory purposes. Those risks are credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation. The organizers must become familiar with these nine risk categories as they apply to the charter proposal. They are discussed thoroughly in the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's earnings and capital. The simple existence of risk is not necessarily reason for concern. To put risks in perspective, the OCC determines whether the risks a bank plans to undertake are warranted. Generally, risks are warranted when they are understandable, measurable, controllable, and within the bank's capacity to readily withstand adverse performance.

## **Risk Management**

Because market conditions and company structures vary, no single risk management system works for all banks. Each institution should develop its own risk management program tailored to its needs and circumstances. The sophistication of the risk management system will increase with the size, complexity, and geographic diversity of each bank. All sound risk management systems, however, have several common fundamentals. For example, bank staff responsible for implementing sound risk management systems performs those duties independent of the bank's risk-taking activities. Regardless of the risk management program's design, each program should include:

- *Risk identification.* Proper risk identification focuses on recognizing and understanding existing risks or risks that may arise from new business initiatives. Risk identification should be a continuous process and occur at both the transaction and portfolio level.
- *Risk measurement.* Accurate and timely measurement of risks is a critical component of effective risk management. A bank that does not have a risk measurement system has limited ability to control or monitor risk levels. Further, the sophistication of the bank's risk measurement tools should reflect the complexity and levels of risks it has assumed. The bank should verify periodically the integrity of the measurement tools it uses. Good risk measurement systems assess both the individual transactions and portfolios.
- *Risk control.* The bank should establish and communicate limits through policies, standards, and procedures that define responsibility and authority. These control limits should be meaningful management tools that can be adjusted if conditions or risk tolerances change. The bank should have a process to authorize exceptions or changes to risk limits when they are warranted.
- *Risk monitoring.* Banks should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative, and should be distributed to appropriate people to ensure action when needed.

Effective risk management requires an informed board of directors. The board must guide the bank's strategic direction. A key component of strategic direction is endorsing the bank's risk tolerance by approving policies that set standards, either orally or in writing. Well-designed monitoring systems allow the board to hold management accountable for operating within established tolerance levels.

Capable management and appropriate staffing also are critical to effective risk management. Bank management is responsible for the implementation, integrity, and maintenance of risk management systems. Management also must keep the directors adequately informed. Management must:

- Implement the bank's strategic direction.
- Develop policies that define the institution's risk tolerance that are compatible with the bank's strategic goals.
- Oversee the development and maintenance of management information systems to ensure they are timely, accurate, and informative.
- Ensure that strategic direction and risk tolerances are communicated effectively and adhered to through the bank's organization structure.

When the OCC evaluates risk management systems, it considers policies, processes, personnel, and control systems. A significant deficiency in one or more of these components constitutes a deficiency in risk management. All of those systems are important, but the sophistication of each will vary depending upon the complexity of the bank. Noncomplex community banks normally have less formalized policies, processes, and control systems in place than do large banks. Those systems are defined as:

- *Policies* are written statements of the bank's commitment to pursue certain results. Policies often set standards (on risk tolerances, for example) and recommend courses of action. Policies should express a bank's underlying mission, values, and principles. A policy review should always be triggered when a bank's activities or risk tolerances change.
- *Processes* are the procedures, programs, and practices that impose order on the bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies, efficient, and governed by appropriate checks and balances (such as internal controls).
- *Personnel* are the staff and managers who execute or oversee processes. Good staff and managers are qualified, competent, and perform as expected. They understand the bank's mission, values, policies, and processes. Banks should design compensation programs to attract, develop, and retain qualified personnel.
- *Control systems* are tools and information systems (for example, internal and external audit programs) that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes.

Feedback should be timely, accurate, and pertinent (in other words, appropriate to the level and complexity of risk taking).

## **Risk Assessments and Ratings**

After each bank opens for business, examiners assess the quantity of risk and the quality of risk management. They then assign each risk an aggregate assessment (low, moderate, or high) and determine whether that risk is expected to decrease, increase, or remain stable over the next 12 months.

Additionally, all financial institutions are evaluated and rated under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Financial Institutions Rating System. This system assesses six components of a bank's performance: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. This is referred to as the CAMELS rating. Each component is rated on a scale of 1 to 5, with 1 being the most favorable rating.

A composite or overall rating ranging from 1 to 5 also is assigned under the CAMELS rating system. A rating of "1" indicates the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile. Those institutions present the least level of supervisory concern. Conversely, a 5-rated institution demonstrates critically deficient performance, inadequate risk management practices, and the highest level of supervisory concern.

## **Specialized Area Supervision**

The OCC also reviews and assigns ratings to specialized functions and areas not specifically addressed in the CAMELS ratings, including consumer compliance, information technology (see the "Bank Supervision Process" booklet of the *Comptroller's Handbook*). These supervisory programs are risk-based and generally integrated into the CAMELS reviews. Examiners with greater knowledge of the specialized area typically conduct the reviews of areas and activities that are deemed high-risk.

### **Assessment of Consumer Compliance**

Under the uniform rating system, the OCC assigns each bank a consumer compliance rating based on an evaluation of its present compliance with consumer protection and civil rights statutes and regulations and the adequacy of its operating systems designed to ensure continuing compliance. Ratings are given on a scale of 1 through 5 in increasing order of supervisory concern. Thus, 1 represents the highest rating and consequently the lowest level of supervisory concern; while 5 represents the lowest, most critically deficient level of performance and, therefore, the highest degree of supervisory concern.

### **OCC Assessment of CRA**

The CRA requires the OCC and other federal regulators to provide written public evaluations of banks' records of performance under the law. The four ratings that may be assigned for a CRA evaluation are: "outstanding," "satisfactory," "needs to

improve,” and “substantial noncompliance.” The OCC assigns those ratings, which are included in the public evaluation, on the basis of the bank’s performance under its applicable assessment method.

CRA evaluations ordinarily are performed on a three-, four-, or five-year cycle, depending on size and overall CRA rating. However, the first CRA examination of a de novo bank will be conducted about 24-36 months after opening.

### **Assessment of Information Technology Operations**

The OCC and the other FFIEC regulatory agencies use the Uniform Rating System for Information Technology (URSIT) to uniformly assess financial institution and service provider risks introduced by information technology. URSIT consists of a composite rating and four component ratings:

- The composite rating is a 1-5 scale reflecting the significance of technology-related risks. The higher the composite rating, the greater the risk. The OCC assigns the URSIT composite rating to all national banks.
- The component ratings, using a 1-5 scale, correspond to the functional activities and related areas of risk that support information technology services and processes. The functional components include the adequacy of the organization’s overall IT audit program (Audit); the abilities of the board and management as they apply to all aspects of IT acquisition, development, and operations (Management); an organization’s ability to identify, acquire, install, and maintain appropriate information technology solutions (Development and Acquisition); and an organization’s ability to provide technology services in a secure environment (Support and Delivery). Full URSIT ratings, component and composite, are assigned only during OCC examinations of entities that provide technology services to national banks.

### **Assessment of Asset Management Activities**

The core assessment for onsite asset management examinations is structured according to the Uniform Interagency Trust Rating System (UITRS). Each bank is assigned a component rating based on an evaluation and rating of five essential components of an institution’s fiduciary activities. Those components are: the capability of management; the adequacy of operations, controls, and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations); sound fiduciary principles; and the management of fiduciary assets.

Composite and component ratings are assigned based on a 1 to 5 numerical scale. As with other examination areas, a 1 is the highest rating and indicates the strongest performance and risk management practices and the least degree of supervisory concern. A 5 is the lowest rating and indicates the weakest performance and risk management practices and, therefore, the highest degree of supervisory concern. Evaluation of the composite and components considers the size and sophistication, the nature and complexity, and the risk profile of the institution’s fiduciary activities.



## Enforcement Actions

The OCC can respond in several ways to violations of laws, rules, regulations, or unsafe or unsound practices or conditions. It will take corrective and remedial action upon discovery of serious safety and soundness or compliance problems. The "report of examination" identifies and communicates clearly the OCC's assessment of a bank's condition and describes its problems, areas of concern or weaknesses, and the primary cause of each. Bank senior management and the board of directors will be expected to take appropriate corrective measures once the OCC has communicated those problems to them. Those actions will be important in determining whether and what enforcement action the OCC should take.

The OCC may take enforcement actions against the bank or against parties affiliated with banks. The OCC's enforcement actions are brought most commonly against banks and their officers and directors. Actions against shareholders are rare, unless the shareholders are involved directly in bank management or in an illegal, unsafe, or unsound activity with the bank. Enforcement actions may be informal or formal. (See *The Director's Book* for a more complete discussion of enforcement actions available to the OCC.)

## Appendix B: Community Reinvestment Act Highlights

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### Responsibility under the Community Reinvestment Act (CRA)

Each national bank has a responsibility under the CRA to help meet the credit needs of its entire community, consistent with the safe and sound operations of such institution. The application should demonstrate how the proposed bank would respond to those needs. The Comptroller of the Currency's (OCC) CRA regulation (12 CFR 25) establishes the framework and criteria by which the OCC assesses a bank's record of helping to meet the credit needs of its community.

### CRA Assessment Area

The CRA regulation requires each bank to delineate at least one assessment area. A retail bank's assessment area or areas generally must consist of one or more metropolitan statistical area or areas (MSAs) or one or more contiguous political subdivisions, such as counties, cities, or towns. It must include the geographies<sup>4</sup> in which the bank has its main office, branches, and deposit-taking ATMs, if any, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans.<sup>5</sup> A bank may adjust the boundaries of its assessment area<sup>6</sup> to include only the portion of a political subdivision that it reasonably can be expected to serve.

Each bank's assessment area(s):

- Must consist only of whole geographies.
- May not reflect illegal discrimination or redlining.
- May not arbitrarily exclude low- or moderate-income geographies, taking into account the bank's size and financial condition.
- May not extend substantially beyond a consolidated metropolitan statistical area boundary or beyond a state boundary unless the assessment area is located in a multistate metropolitan statistical area.<sup>7</sup>

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<sup>4</sup>"Geography" is defined in the CRA regulation to mean a census tract or block numbering area delineated by the United States Bureau of the Census in the most recent decennial census. 12 CFR 25.12(l).

<sup>5</sup>12 CFR 25.41(c).

<sup>6</sup>12 CFR 25.41(d).

<sup>7</sup>12 CFR 25.41(e).

## Performance Standards

The CRA regulation provides the methods by which the OCC evaluates a national bank's record of helping to meet the credit needs of its assessment area(s). Different evaluation methods are employed based on the bank's size and business strategy. A description of the evaluation methods follows.

- **Small banks** are banks reporting total assets of less than \$1 billion as of December 31 of either of the prior two calendar years. The OCC evaluates the CRA performance of a small bank with total assets of less than \$250 million through the small bank lending test. This test focuses primarily on lending and lending-related activities in the bank's assessment area. It includes an evaluation of the bank's loan-to-deposit ratio, percentage of loans and other lending-related activities located in the bank's assessment area, the record of lending to and engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes, the geographic distribution of the bank's loans, and the bank's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s).
- **Intermediate small banks** are small banks with assets of at least \$250 million as of December 31 of both of the prior two calendar years and less than \$1 billion as of December 31 of either of the prior two calendar years. The overall CRA rating for an intermediate small bank is based both on the rating from the small bank lending test, described in the preceding paragraph, and the rating from a community development test that is applicable to intermediate small banks only. The community development test evaluates the number and amount of community development loans, the number and amount of qualified investments, and the provision of community development services, and the bank's responsiveness through such activities to community development lending, investment, and service needs. The bank's responsiveness to assessment area community development needs is evaluated in the context of the bank's capacity and business strategy, as well as the community development opportunities in the assessment area.

The CRA regulation allows both small and intermediate small banks the option to be examined as a large bank under the lending, investment, and service tests (as described under the following bullet), provided the bank collects, maintains, and reports the data required by the CRA regulations. The asset threshold dollar figures for both small and intermediate small banks are adjusted annually based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million. The asset threshold adjustments are published in the *Federal Register*. For further details regarding the definition of small and intermediate small banks, refer to [OCC-Bulletin 2005-28](#), dated August 24, 2005.

- **Large banks** (those that do not meet the definition of a small bank) typically are evaluated under the lending, investment, and service tests. As their names imply, these tests focus on the banks' performance in lending (home mortgage, small business, and small farm, and generally, at the bank's option,

consumer lending), as well as community development (CD) lending, with a primary focus on the bank's assessment area; making investments (qualified investments that benefit the bank's assessment area or a broader statewide or regional area that includes the assessment area); and providing services (retail banking services, alternative delivery systems, and CD services).

- The community development test (CD test) is available to banks that the OCC has designated as **limited-purpose or wholesale banks** (see Glossary). This test evaluates the bank's CD lending, qualified investments, and CD services — first in the bank's assessment areas or the broader statewide or regional area that includes its assessment areas, and, if the bank has adequately addressed credit needs in that area, nationwide.
- The **strategic plan** evaluation method is available to all banks without regard to size or business strategy. A bank electing this evaluation method seeks informal and formal public comment during the development of its plan. The plan, which is submitted to the OCC for approval, may have a term of up to five years. It must include annual interim measurable goals for helping to meet the credit needs of the bank's assessment area through various lending, investment, and service activities. Although a plan must address all three types of activities, emphasis may be placed on one or more of the activities, depending on the bank's capacity and constraints, product offerings, and business strategy. If a bank meets the goals specified in the plan for satisfactory performance, the bank will be rated satisfactory. (The bank also may include goals that represent outstanding performance.) The strategic plan option provides a more flexible alternative to a bank that is concerned that the requirements of the other tests are too rigid for the nature of its operations. Some banks open under the small bank test or the lending, investment, and service tests, but plan to develop a strategic plan after a period of transactional history.

## Appendix F: Compliance Highlights

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This Appendix highlights some of the concerns that the Comptroller of the Currency frequently identifies about fair lending statutes, the Bank Secrecy Act (BSA), and anti-money laundering provisions, privacy, and advertising. More detailed information about compliance with these and other consumer compliance issues is available in pertinent booklets in the *Comptroller's Handbook*.

### Fair Lending Statutes

The federal fair lending statutes are the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FH Act). The ECOA prohibits discrimination in any part of a credit transaction. The ECOA applies to any extension of credit, including extensions of credit to persons, small businesses, corporations, partnerships, and trusts. The FH Act applies to residential real estate related transactions. Both of these acts prohibit discrimination based on race, color, religion, sex, or national origin. The ECOA also prohibits discrimination based on age, marital status, receipt of public assistance, or the exercise of a right under the Consumer Credit Protection Act. The FH Act also prohibits discrimination based on handicap or familial status. Generally, discrimination in a credit transaction against persons because they are (or are not) members of a group previously categorized violates the ECOA and, if the transaction is related to residential real estate, violates the FH Act.

### Bank Secrecy Act and Anti-Money Laundering Provisions

The Bank Secrecy Act (BSA) and its implementing regulations require financial institutions to file certain currency and monetary instrument reports and to maintain certain records for possible use in criminal, tax, and regulatory proceedings (31 USC 5311, 31 CFR 103, 12 CFR 21.21). Congress enacted the BSA to attempt to prevent financial institutions from being used as intermediaries for the movement of criminally derived funds to conceal the true source, ownership, or use of the funds, that is, money laundering. Although attempts to launder money through a legitimate financial institution can emanate from many different sources, certain kinds of businesses, transactions, or geographic locations may lend themselves more readily to potential criminal activity than others.

All banks must establish and maintain procedures reasonably designed to ensure and monitor their compliance with the BSA and its implementing regulations. This requires national banks to establish a compliance program that includes, at a minimum, adequate BSA policies and procedures, designation of a compliance officer, and BSA training and audits. In addition, national banks should be aware of various criminal statutes prohibiting money laundering and structuring of deposits to evade the BSA reporting requirements. (See 18 USC 1956, 1957 and 31 USC 5324.)

Banks must ensure that they have reasonable policies and procedures to verify the identity of people seeking to open an account at the bank and to detect suspicious activity. Each bank must file a Suspicious Activity Report (SAR) whenever it identifies:

- A known or suspected violation of law.

- A suspicious transaction that:
  - Has no business or apparent lawful purpose.
  - Is not the sort of transaction in which a particular customer normally would be expected to engage.
  - Has no reasonable explanation.
- A suspicious transaction for more than \$5,000 involving potential money laundering.
- A suspicious transaction that is an apparent attempt to evade the provisions of the BSA.

The SAR reporting requirements are provided in 12 CFR 21.11.

The USA PATRIOT Act of 2001 (Patriot Act) amended the BSA by providing strong measures to prevent, detect, and prosecute terrorism and international money laundering. The Patriot Act establishes new rules and responsibilities affecting United States banking organizations, other financial institutions, and nonfinancial commercial businesses. The Patriot Act:

- Provides the Secretary of the Treasury with the authority to impose special measures on jurisdictions, institutions, or transactions that are of "primary money-laundering concern."
- Requires financial institutions to increase their due diligence standards when dealing with foreign private banking and correspondent accounts.
- Prohibits correspondent accounts with foreign "shell" banks.
- Expands the ability of the public and private sectors to share information related to terrorism and money laundering investigations.
- Facilitates records access and requires banks to respond to regulatory requests for information within 120 hours.
- Establishes minimum standards for customer identification at account opening and requires checks against government-provided lists of known or suspected terrorists.
- Extends an anti-money laundering program requirement to all financial institutions.
- Increases the civil and criminal penalties for money laundering.

## Safeguarding Customer Information

Information is one of the bank's most important assets. As mandated by Section 501 of Gramm-Leach-Bliley Act of 1999 (GLBA), a bank must establish appropriate processes to safeguard customer information. Such safeguards must:

- Ensure the security and confidentiality of customer records and information.
- Protect against any anticipated threats or hazards to the security or integrity of such records.
- Protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

The bank must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the bank and the nature and scope of its activities. (Refer to OCC Bulletin 2001-35 and OCC Bulletin 2001-8 for the specific guidelines for safeguarding customer information. Also see the FFIEC IT Examination Handbook Series, Information Security booklet.)

## Verification

Each bank must implement effective processes to verify the identity of new customers at account opening and to authenticate existing customers when they initiate transactions. A bank offering deposit-related products and services must ensure that it adequately verifies the identity of its customers. Deposit-related products and services include noninterest-bearing demand deposits, interest checking, money market accounts, certificates of deposit, and electronic bill payment.

The OCC expects banks to exercise appropriate caution and due diligence when opening accounts. Customer verification is the process that a bank uses for new accounts to corroborate the identity of new customers. A new account process involves requesting a variety of customer information items, including name, address, phone number, social security number, and driver's license information, among other things. The bank independently verifies the accuracy of this information.

Internal systems and controls should include appropriate procedures to verify customer information as part of the account opening process and to monitor for fraud and suspicious activity after an account has been opened. A bank should monitor the verification and account authorization procedures continually to ensure a rigorous process for identifying, measuring, and managing the risk exposures. This process should include a regular audit function to test the controls and ensure they continue to meet the defined control objectives.

These procedures for access control also are essential for preventing fraud, money laundering, and other abuses. To limit the risk of money laundering, some banks restrict the type of business they will accept. For example, some banks do not accept, or they place additional controls over, accounts from foreign government officials, certain money service businesses, military equipment sales companies, and

political or gambling organizations. Banks also may restrict account activity by prohibiting cash or monetary instrument deposits.

## Privacy

National banks are subject to a number of federal statutes and regulations that govern the disclosure of consumer information. The most comprehensive of these provisions is Title V of the GLBA that requires banks and other financial institutions to provide consumers of their financial products or services with privacy notices and an opportunity to opt out of certain information sharing with nonaffiliated third parties. Banks also are subject to the Fair Credit Reporting Act (FCRA), which governs the use and disclosure of consumer reporting information. Additionally, banks should be aware of the Electronic Fund Transfer Act, the Right to Financial Privacy Act, the Children's Online Privacy Protection Act, and the Federal Trade Commission Act.

## GLBA Privacy Provisions

The GLBA enacted privacy-related provisions applicable to financial institutions. The federal banking regulatory agencies promulgated final rules (see 12 CFR 40) to implement these provisions.

In general, the regulations require banks to provide their customers with notices that accurately describe their privacy policies and practices, including their policies for the disclosure of nonpublic personal information<sup>8</sup> to their affiliates and to nonaffiliated third parties. The notices must be provided at the time the customer relationship is established and annually thereafter. Notices must be clear and conspicuous and provided so that each intended recipient reasonably could be expected to receive actual notice. The notices must be in writing or may be delivered electronically if the consumer agrees.

Subject to specified exceptions that permit banks to share information in the ordinary course of business, banks may not disclose nonpublic personal information about consumers to any nonaffiliated third party, unless consumers are given a reasonable opportunity to direct that their information not be shared (opt out). Thus, before a bank may disclose nonpublic personal information about a consumer (even if not a "customer") to a nonaffiliated third party, the bank must provide the consumer with an initial privacy notice and an opt-out notice (which may be included in the privacy notice).

The GLBA regulations also provide that a bank generally may not disclose an account number or similar form of access number or code for a credit card account, deposit account, or transaction account of a consumer to any nonaffiliated third party for use in marketing. A bank may, however, disclose its customer account numbers to third-party agents or servicers to market the bank's own products or services,

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<sup>8</sup>Generally this means any information that is provided by a consumer to a bank to obtain a financial product or service, that results from a transaction between a bank and a consumer involving a financial product or service, or that is otherwise obtained by a bank in connection with providing a financial product or service to a consumer. If a bank obtains information about its consumers from a publicly available source, that information will not be protected (that is, subject to notice and opt out) unless the information is disclosed as part of a list, description, or other grouping of a bank's consumers.



provided the bank does not authorize the third party to initiate charges to customer accounts. The regulations also limit the redisclosure and reuse of nonpublic personal information obtained from other nonaffiliated financial institutions.

## FCRA Information Sharing Provisions

The FCRA sets standards for the collection, communication, and use of information bearing on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living. The communication of this type of information may be a "consumer report" subject to the FCRA's requirements. However, the FCRA specifically excepts from the definition of consumer report: (1) the disclosure of a bank's own transaction and experience information to any third party; and, (2) the disclosure of consumer reporting information to a bank's affiliates if the bank first notifies its consumers that it intends to share such information and allows them to opt out of this information sharing (affiliate information sharing) (12 CFR 40).

As a general matter, a bank will not be subject to the FCRA's requirements that apply to consumer reporting agencies<sup>9</sup> if the bank communicates information only in a manner consistent with the two exceptions described previously. However, a bank may be subject to other FCRA requirements, for example, as a user of credit reports.

Banks' information disclosures may be subject to both the GLBA and the FCRA. Therefore, banks must understand the differences between the GLBA and the FCRA provisions to reduce compliance risks in this area. The statutes differ in the scope of their coverage and their requirements for a bank's treatment of consumer information. As a result, what may be a permissible disclosure under one statute may be prohibited or subject to different conditions under the other statute. Because compliance with one statute will not entail compliance with the other, banks are strongly advised to evaluate the requirements of both laws in connection with their disclosures of consumer information. (For a more detailed discussion, see OCC Bulletin 2000-25, Privacy Laws and Regulations.)

## Other Privacy Provisions

Banks and their subsidiaries should be aware of the following federal laws that may affect their consumer financial information practices:

- The Electronic Fund Transfer Act and Regulation E require that banks make certain disclosures when a consumer contracts for an electronic transfer service or before the first electronic fund transfer is made involving the consumer's account.
- The Right to Financial Privacy Act prohibits a bank from disclosing a customer's financial record to the federal government, except in limited circumstances, such as pursuant to the customer's authorization, an administrative subpoena or summons, a search warrant, a judicial subpoena,

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<sup>9</sup>These requirements relate to furnishing consumer reports only for permissible purposes, maintaining high standards for ensuring the accuracy of information in consumer reports, resolving consumer disputes, and other matters.

or a formal written request for a legitimate law enforcement inquiry, or to a supervisory agency for its supervisory, regulatory, or monetary functions.

- The Children's Online Privacy Protection Act (COPPA) establishes requirements applicable to the collection, use, or disclosure of personal information about children that is collected through the Internet or another online service. Banks are subject to COPPA if they operate a Web site or online service (or portion thereof) directed to children, or have actual knowledge that they are collecting or maintaining personal information from a child online.
- The Federal Trade Commission Act (FTC Act) prohibits unfair or deceptive acts or practices in or affecting commerce, and provides a basis for government enforcement actions against deception resulting from misleading statements concerning a company's privacy practices or policies, or failures to abide by a stated policy.

## Advertising

Advertisements on Web sites must meet the advertising requirements of Regulation B (Equal Credit Opportunity Act), Regulation M (Consumer Leasing), Regulation Z (Truth in Lending), Regulation DD (Truth in Savings), and the FTC Act.<sup>10</sup> Interim final rules, published March 30 and April 4, 2001,<sup>11</sup> establish uniform standards for using electronic communications under Regulations B, E, M, Z, and DD. Although compliance with the interim rules is not mandatory, they provide effective guidance that banks should consider when developing electronic disclosures.

Banks must be aware of the regulatory requirements for the prominence of certain disclosures in their advertisements. Banks also must consider the requirements of Regulations M and Z that permit creditors and lessors to provide required advertising disclosures on more than one page, if certain conditions are met. Banks should monitor carefully amendments to these regulations to ensure compliance with multipage advertising in the context of electronic advertisements. Banks must comply with the triggering term requirements of Regulations M, Z, and DD ensuring that the terms are disclosed appropriately and are set forth clearly and conspicuously.

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<sup>10</sup>There are no FTC Act regulations addressing electronic advertisements. However, electronic advertisements, such as print advertisements, may not be unfair or deceptive.

<sup>11</sup>66 Fed. Reg. 17779 (April 4, 2001) (Regulation B). 66 Fed. Reg. 17786 (April 4, 2001) (Regulation E). 66 Fed. Reg. 17322 (March 30, 2001) (Regulation M). 66 Fed. Reg. 17329 (March 30, 2001) (Regulation Z). 66 Fed. Reg. 17795 (April 4, 2001) (Regulation DD).

## Appendix C: Significant Deviations After Opening

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For the first three years of operation, the Comptroller of the Currency (OCC) requires each national bank to provide prior notice and obtain a no objection letter from the appropriate OCC supervisory office before making a significant deviation from the business plan submitted with its charter application. This is a condition imposed in writing within the meaning of 12 USC 1818.

### Purpose

Generally, the OCC uses this significant deviation condition to address heightened supervisory risk that exists during the first several years of a new bank charter's operations, or that exists in unusual cases after a conversion, merger, or other filing. This condition is a standard condition required for all new bank charter approvals.

New banks are particularly vulnerable to internal and external risks until they achieve a certain level of stability and profitability, clearly justifying the imposition of the significant deviation condition. The condition provides the OCC with the opportunity to evaluate any enhanced risks presented before the bank initiates a significant change to its business plan or operations.

### Identification

A significant deviation or change for the purposes of this condition is defined as "a material variance from the bank's business plan or operations that occurs after the proposed bank has opened for business." Significant deviations may include, but are not limited to, deviations in the bank's:

- Projected growth, such as planned significant growth in a product or service.
- Strategy or philosophy, such as significantly reducing the emphasis on its targeted niche (for example, small business lending) in favor of significantly expanding another area (for example, funding large commercial real estate projects).
- Lines of business, such as initiating a new program for subprime lending.
- Funding sources, such as shifting from core deposits to brokered deposits.
- Scope of activities, such as establishing transactional Internet banking or entering new, untested markets.
- Stock benefit plans for de novo banks, including the introduction of plans that were not previously reviewed during the chartering process with "no objection" by the OCC.
- Relationships with a parent company or affiliate, such as a shift to significant reliance on a parent or affiliate as a funding source or provider of back-office support.

Changes in bank control or management are not considered significant deviations for purposes of this condition because existing law and regulation<sup>12</sup> provide other means for prior notification and an opportunity for OCC objection.

**Deviations in financial performance alone are not significant deviations under this condition.** However, the OCC still may consider the underlying reason(s) for a deviation in financial performance a significant deviation. For example, a bank could deviate from its pro forma balance sheet or budget because of significant growth caused by a new product that was not disclosed in the business plan or initial plan of operations. This is an example of a significant deviation that requires prior written notification to, and a written determination of no objection from, the supervisory office. On the other hand, if the bank's strategies are consistent with the business plan, but the bank simply experiences significantly more growth than planned, that growth, by itself, does not qualify as a significant deviation for this condition.

Nevertheless, examiners will evaluate the supervisory risk that deviations from projected financial performance may pose to the bank, and what, if any, supervisory response is appropriate under the circumstances. For example, an examiner could determine that the bank's risk management systems are no longer adequate given the magnitude of the unplanned growth, and that deficient systems are a Matter Requiring Attention.

## Evaluation

Upon receipt of a prior notice, the supervisory office will evaluate the proposed deviation. The evaluation should determine whether the deviation significantly elevates the bank's risk profile. The OCC assesses risk by its potential impact on a bank's earnings and capital. The OCC recognizes that some deviations are necessary or prudent. For example, a deviation from the business plan may be necessary to meet changes in local market conditions.

Examiners will determine whether the risks that a bank undertakes, or proposes to undertake, are properly managed. Generally, risks are warranted if they are identified, understood, measured, monitored, controlled, and within the bank's capacity to withstand any financially adverse results. If examiners determine that risks are unwarranted, they will communicate to the bank's management and directors that a need exists to mitigate or eliminate the excessive risks. Appropriate actions may include reducing exposures, increasing capital, or strengthening risk management processes. (See the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more detailed discussions of risks and risk management systems.)

Examiners, bank management, and directors may find it beneficial to consult their district's Licensing staff when reviewing adherence to, or evaluating significant deviations from, a bank's business plan.

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<sup>12</sup> The Change in Bank Control Act in 12 USC 1817(j) and the OCC's implementing regulation in 12 CFR 5.50 generally require prior notification of a change in bank control. As a condition of the charter approval, the OCC retains the right to object to and preclude the hiring of any officer, or the appointment or election of any director, for a two-year period from the date the bank commences business (12 CFR 5.20(g)(2)).

## Supervisory Actions and Communications

If the evaluation of a proposed significant deviation results in little or no supervisory concern, the supervisory office should send a "no objection" letter to the bank. To mitigate concerns, the supervisory office may determine that it is prudent to condition its no objection. In these cases, the no objection letter will identify the conditions as conditions "imposed in writing by the agency in connection with the granting of any application or other request." The OCC is required to publish documents containing enforceable conditions. Accordingly, the supervisory office must submit a copy of all conditional no objection letters to headquarters Licensing for publication in *Interpretations and Actions*.

If the evaluation discloses supervisory concerns with a proposed deviation, the supervisory office sends an "objection" letter detailing the reasons for this determination. If, despite the issuance of an objection letter, a bank subsequently engages in actions that reflect a significant deviation to, or change from, its business plan, additional supervisory or enforcement action will be considered, consistent with the OCC's Enforcement Policy (PPM 5310-3 Revised).

If a significant deviation from the bank's business plan is disclosed during a supervisory activity (examination or periodic monitoring), and the bank has failed to obtain prior written determination of no objection, the resulting supervisory action will reflect the degree of supervisory concern with the deviation. At a minimum, a national bank examiner will cite a violation of the Regulatory Condition Imposed in Writing (RCIW) (in other words, the significant deviation condition — 12 USC 1818). A violation of an RCIW can provide the basis for the assessment of civil money penalties or other enforcement actions. The OCC will communicate all supervisory actions to the bank in writing.

## Glossary

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An application is **completed** when the items specified in the Charter Application Checklist are satisfied.

The term **affiliate** includes, among other things, any "company" that controls a bank and any company that is controlled by the same person or company as controls the bank (12 USC 371c as implemented by Regulation W, 12 CFR 223).

An entity controlling a bank must be approved by the Federal Reserve Board as a **bank holding company** (BHC), if the controlled bank is covered by the definition of a bank found in the Bank Holding Company Act (BHCA) (12 USC 1841(c)). Certain limited purpose banks, such as Competitive Equality Banking Act of 1987 (CEBA) credit card banks and trust banks, are not defined as banks under the BHCA.

A **bankers' bank** is a national bank owned exclusively, except for directors' qualifying shares, by other depository institutions or depository institution holding companies. Bankers' bank activities are limited to providing:

- Services to or for other depository institutions, their holding companies, or the officers, directors, and employees of such institutions.
- Correspondent banking services at the request of other depository institutions or their holding companies.

After filing the Articles of Association and Organization Certificate, a national bank becomes a **body corporate** or legal entity as of the date the organizers sign the Organization Certificate and adopt the Articles of Association.

A **Business Continuity Plan** addresses all critical services and operations that are provided by internal departments and external sources. The planning process reviews the various departments, units, or functions and assesses each area's importance for the viability of the organization and provision of customer services. Plans are developed to cover restoring critical areas should they be affected by physical disasters, such as fires or flooding; environmental disasters (such as hurricanes or tornados); or other disasters (such as power or telecommunication failure).

A **central city**, as defined in 12 CFR 5.3(e), means the city or cities identified in the complete title of the Metropolitan Statistical Area (MSA) in which the relocating office is located.<sup>13</sup>

The **contact person** (also **spokesperson**) is an organizer and proposed director of a proposed bank, who is designated by the organizing group to represent it in all

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<sup>13</sup>The Office of Management and Budget's (OMB) lists of MSAs and Central Cities can be found on the Internet at <http://www.census.gov>. At the "Subjects A-Z" menu, click on "M," then on Metropolitan Areas, then on Metropolitan Area Definitions, then on Central Cities of Metropolitan Areas. Copies of the OMB list may also be obtained by requesting the most recent "List of Metropolitan Area Definitions" (accession no. PB96-180575) from National Technical Information Services (NTIS), Document Sales, 5205 Port Royal Road, Springfield, VA 22161, (703) 487-4650.

contacts with the OCC. In certain circumstances (excluding independent charters), the contact person instead may be a representative of:

- A holding company sponsor.
- People currently affiliated with other depository institutions.
- People who, in the OCC's view, otherwise are collectively experienced in banking and have demonstrated the ability to work together effectively.

**Control** has the same meaning as used in the BHCA (12 USC 1841(a)(2)), except when the term is used in connection with affiliated transactions, in which case, "control" has the meaning set forth at 12 CFR 223.3(g).

A **de novo BHC** is one that has been in existence less than three years, including one that is in the process of formation.

A **director** is a member of the board of directors of a bank. Collectively, the directors have a critical role in the successful operation of the bank. They are ultimately responsible for the conduct of a bank's affairs, and the health of the bank depends upon their being strong, independent, and attentive. They also are accountable to the bank's shareholders and the bank's depositors, regulators, and the communities served by the bank. For purposes of determining applicability of, and compliance with, 12 USC 375b as implemented by Regulation O, the term "director" is defined at 12 CFR 215.2(d) and means any director of the company or bank, whether or not receiving compensation, and includes certain advisory directors.

A **Disaster Recovery Plan** is a part of the business resumption plan. It includes protection against physical disasters and other disruptions to operations; backup considerations related to hardware, software, applications, documentation, procedures, data files, and telecommunication; and insurance policies regardless of the type of computer equipment and software, and size of the information systems facilities within the organization.

A **dormant bank** is a bank that is no longer engaged in core banking activities other than on a *de minimis* basis. This definition includes, for example, a bank that has significantly reduced its activities and services or that has contracted out significant portions of its operations to third party service providers, other than in the ordinary course of the bank's ongoing business.

**E-banking** is the automated delivery of new and traditional banking products and services directly to consumers through electronic, interactive communication channels. E-banking includes the systems that enable financial institution customers, individuals, or businesses, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet.

An **effective** registration statement is one that meets the requirements set forth in 12 CFR 16.15 for the solicitation of stock to capitalize a new national bank, and has been authorized by the OCC for use in offering for sale and selling stock in the new national bank.

An **eligible bank** is a national bank that:

- Has a composite CAMELS rating of 1 or 2.
- Has a satisfactory or better CRA rating. (This factor does not apply to an uninsured bank, an uninsured federal branch, or a special purpose bank covered by 12 CFR 25.11(c)(3).)
- Is well capitalized as defined in 12 CFR 6.4(b)(1).
- Is not subject to a cease and desist order, consent order, formal written agreement, or prompt corrective action directive; or, if subject to any such order, agreement, or directive, is informed in writing by the Comptroller of the Currency (OCC) that the bank still may be treated as an "eligible bank."

An **eligible depository institution** means a state bank or a federal or state savings association that meets the criteria for an "eligible bank" under 12 CFR 5.3(g) and is FDIC-insured.

An **established company** is one that has been operating for more than three years and will become a parent of a national bank when the bank opens for business, regardless of whether it will also become a BHC.

An **executive officer** of a bank is a person who participates in or has the authority to participate in (other than in the capacity of a director) major policymaking functions of the bank, whether or not the person has an official title, is designated as an assistant, or serves without compensation. Executive officer positions normally include the chairman of the board, president, every vice president, cashier, secretary, treasurer, chief investment officer, and any other person the OCC identifies as having significant influence over major policymaking decisions.

An **existing BHC** is one that received Federal Reserve System approval to become a BHC and has been operating as a BHC for at least three years prior to filing its application to organize a new bank.

To be **experienced in banking**, the majority of an organizing group's members must have five or more years of recent significant involvement in policy making as directors or executive officers in the same institution or affiliated federally insured institutions that the OCC finds have performed satisfactorily. (See **recent experience**.)

**Feasibility analysis** is the process of determining the likelihood that a proposal will fulfill specified objectives.

**Final approval** means the OCC action of issuing a charter certificate and authorizing a national bank to open for business.

A **financial subsidiary** is any company controlled by one or more insured depository institutions. It is not a subsidiary that engages solely in activities that a national bank may engage in directly (in other words, an operating subsidiary) or a subsidiary that is specifically authorized by the express terms of a federal statute other than 12 USC 24a, such as a bank service company. A financial subsidiary may engage in specified activities that are financial in nature or incidental to financial activities if



the bank and the subsidiary meet certain requirements and comply with stated safeguards. For purposes of Regulation W (12 CFR 223), a financial subsidiary does not include a company that is only a financial subsidiary solely because it engages in the sale of insurance as agent or broker in a manner that is not permitted for a national bank.

**Founders** are individuals who provide funding for organization costs but are not otherwise involved in the organization or ongoing operation of the bank, except as a shareholder.

**Holding company** means any company that controls or proposes to control a national bank regardless of whether it is a BHC under 12 USC 1841(a)(1).

A **hyperlink** is an item on a Web page that contains coding that transfers the user directly to another location in a hypertext document or to another Web page, perhaps on a different machine. Also called a "link."

An **insider** is a proposed organizer, director, principal shareholder, or executive officer of the proposed national bank. For purposes of determining applicability of, and compliance with, 12 USC 375a and 375b as implemented by Regulation O, the term "insider" is defined at 12 CFR 215.2(h) and means an executive officer, director, or principal shareholder, and includes any related interest of such a person.

An **insider contract** is any financial or other business, voting, or ownership agreement, arrangement, or transaction, direct or indirect, oral or written, between any insider and the proposed bank.

**Internet banking** is a system that enables bank customers to access accounts and general information on bank products and services through a personal computer (PC) or other electronic device. Also see e-banking definition.

**Internet service provider** is an entity that provides access or service related to the Internet, generally for a fee.

**Lead depository institution** means the largest depository institution controlled by a BHC, based on a comparison of the total assets controlled by each depository institution as reported in its Consolidated Report of Condition and Income (call report) required to be filed for the immediately preceding four calendar quarters.

**Limited purpose bank** means a bank that offers only a narrow product line (such as credit card or motor vehicle loans) to a regional or broader market and for which a designation as a limited purpose bank is in effect. A bank may request the OCC to designate it as a limited purpose bank for CRA purposes as provided in 12 CFR 25.25(b).

A **low- or moderate-income area**, as provided in 12 USC 1831r-1, means a census tract for which the median family income is: (1) less than 80 percent of the median family income for the MSA in which the census tract is located; or, (2) in the case of a census tract that is not located in an MSA, less than 80 percent of the median family income for the state in which the census tract is located, as determined without considering family income in MSAs in such state.

The **market test** reflects an organizing group's ability to raise the required capital stated in its business plan, and in the manner described, within 12 months of preliminary conditional approval.

A **narrow focus bank** is one that offers limited services or anticipates serving a narrowly defined market niche. For example, a narrow focus bank would include one that proposes to offer a lending portfolio that is heavily concentrated or targets a restricted customer base.

A **national bank** means an insured or uninsured national banking association.

A **newly organized BHC or non-BHC parent** is one that has been operational for less than three years.

An **officer** of a bank includes executive officers as well as subordinate management officials appointed by the bank's board of directors or through authority properly delegated by the board of directors.

The **organization phase** for a national bank covers the period between the time the OCC grants preliminary conditional approval to the application and the day the national bank opens for business.

**Organization costs**, which are a subset of start-up costs, are the direct costs incurred to incorporate and charter a bank. Such direct costs include, but are not limited to, professional fees (such as legal, accounting, and consulting), printing costs related directly to the chartering or incorporation process, filing fees paid to chartering authorities, and the cost of economic impact studies. Organization costs incurred by newly chartered banks should not be capitalized.

**Organizers** are the persons who filed and signed the charter application. The OCC may approve additional organizers and organizing directors throughout the charter process subject to review and no objection (see "Background Investigations" booklet).

**Organizing group** means five or more persons acting on their own behalf, or serving as representatives of a sponsoring holding company, who apply to the OCC for a national bank charter.

**Person**, as defined in this booklet, has the same meaning as set forth in the Change in Bank Control Act (CBCA) and the OCC's implementing regulation (12 USC 1817(j) and 12 CFR 5.50, respectively). In the context of affiliate transactions, "person" has the meaning set forth in 12 CFR 223.3(bb) of Regulation W.

**Preliminary conditional approval** means a decision by the OCC permitting an organizing group to proceed with the organization of a proposed national bank. A preliminary conditional approval generally is subject to certain requirements and conditions that an applicant must satisfy before the OCC will grant final approval, and it is also subject to special conditions that will remain in place after the bank opens for business.

**Preopening expenses**, such as salaries, employee benefits, rent, depreciation, supplies, directors' fees, training, travel, postage, and telephone, are not considered

organization costs and should not be capitalized. In addition, allocated internal costs, such as management salaries, shall not be capitalized as organization costs.

A **principal shareholder** is a person, other than an insured bank, that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the proposed bank consistent with the definition in 12 USC 375b, as implemented by Regulation O, 12 CFR 215.2(m).

**Recent experience** means service as a director or executive officer of a well-run financial institution for a minimum of two consecutive years, with at least part of this service within the five years immediately preceding filing of the charter application.

A **related interest** of a principal shareholder, executive officer or director (person) includes (1) a company that is controlled by that person or (2) a political or campaign committee that is controlled by that person or the funds or services of which will benefit that person. All of these terms are further defined by 12 CFR 215.2.

A **shell operation** occurs when a bank significantly reduces its activities and services or when a bank contracts out significant portions of its operations to third-party service providers. Such a bank is referred to sometimes as a **shell bank**.

A **significant deviation** is a material variance from the bank's business plan or operations that occurs after the proposed bank has opened for business.

**Spokesperson** is a term sometimes used for a contact person (see definition of contact person).

**Start-up costs** are defined broadly as the costs associated with the one-time activity related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer, or commencing some new operation. Start-up activities include activities related to organizing a new entity, such as a bank, the costs of which are referred to as organization costs. For a new bank, preopening expenses (such as salaries and employee benefits, rent, depreciation, supplies, director's fees, training, travel, postage, and telephone) are considered start-up costs. Organization costs are also considered start-up costs.

A new bank is a **subsidiary of a holding company** if 25 percent or more of its voting stock will be owned or controlled by a holding company or if the FRB (or the OCC, as appropriate) determines that a holding company otherwise has the power to elect a majority of the directors or to control the bank in any other manner.

**Troubled condition** means a bank that has a composite rating of 4 or 5; or is subject to a cease and desist order, a consent order or a formal written agreement (unless otherwise informed in writing by the OCC); or is informed in writing by the OCC that as a result of an examination it has been so designated.

**Weblinking** is the use of hyperlinks to direct users to Web pages of other entities.

**Wholesale bank** means a bank that is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and for which designation as a wholesale bank is in effect. A bank may request the OCC to designate it as a wholesale bank for CRA purposes as provided in 12 CFR 25.25(b).

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