# BANK AND BANK HOLDING COMPANY

# STATEMENT OF POLICY

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# STATEMENT OF POLICY
# GENERAL

The policy statement of the Department of Banking and Finance ("Department") is intended to provide the public and the banking industry with a better understanding of the basis for decisions by the Department. The policy statement is intended to provide insight into the decision-making process in most cases. However, deviations from these general processes may be appropriate in certain situations. The policy is subject to review and revision to reflect changes in law, guidance, standards, and interpretations.

References to laws and regulations are generally not incorporated in this policy statement. Applicable laws are generally found in Chapter 1 of Title 7 of the Financial Institutions Code of Georgia which can be accessed from the Georgia General Assembly's website at www.legis.ga.gov. The Rules and Regulations of the Department are available on the Secretary of State's website at http://rules.sos.ga.gov/. State-chartered banks and bank holding companies are subject to the dual supervision of the Department and one or more federal banking agencies, and applicants should consult those agencies to determine if concurrent application for approval by the State, as well as the federal agency, is required. Forms and instructions utilized by federal agencies as well as their policy pronouncements must be obtained from the federal agency unless specific instructions accompanying State forms indicate otherwise. Any portions of the application that the applicant requests to be confidential should be submitted separately and so noted when the application is filed. Based on the content, the Department will determine whether the information will be considered confidential. In most instances the confidentiality request will be honored.

In the event of any conflict between the Statement of Policy and Georgia law or the Department's rules and regulations, Georgia law and the Department's rules and regulations will control over the Statement of Policy.

## EXPEDITED PROCESSING

Applications which meet the following criteria shall be accorded expedited treatment regarding the application process as indicated in this policy and in the application manual.

## CRITERIA FOR EXPEDITED PROCESSING OF BANK APPLICATIONS (OTHER THAN A CHARTER)

1. The depository institution must be well capitalized as defined in the appropriate capital regulation and guidance of the institution's primary federal regulator;

2. The depository institution must have received a CAMELS composite rating of "1" or "2" as a result of the most recent state or federal examination;

3. The depository institution must have a satisfactory or better Community Reinvestment Act rating from its primary federal regulator at its most recent examination; and

4. The depository institution must not be subject to any agreements, orders, prompt corrective action directives or other enforcement or administrative agreements with the Department or its primary federal regulator or other chartering authority.

In addition, the Department may deny or remove from expedited processing any institution's application where it finds that:

a) Safety and soundness concerns of the Department dictate a more comprehensive review;

b) Any material adverse comment is received by the Department;

c) Other supervisory concerns, legal issues, or policy issues come to the attention of the Department;

d) If applicable, any acquisition of fixed assets would cause the institution to exceed the state fixed asset limitation; or

e) Any other good cause exists for denial or removal.

In this event, the institution will be notified that expedited processing is not available, the reason, and instructions as to how to proceed.

## CRITERIA FOR EXPEDITED PROCESSING OF BANK CHARTER APPLICATIONS WHERE THE BANK IS BEING ESTABLISHED AS A WHOLLY-OWNED SUBSIDIARY OF AN EXISTING BANK HOLDING COMPANY

Pursuant to O.C.G.A. Section 7-1-608(b)(3), a bank holding company registered with the Department and owning a bank that does a lawful banking business in this state may acquire control through the formation of a de novo bank in Georgia. When the proposed institution is being established as a wholly-owned subsidiary of an "**eligible holding company**", the processing period will be shorter and the application may be abbreviated under certain circumstances. An "eligible holding company" is defined as a bank or thrift holding company that:

- has consolidated assets of $150 million or more;

- has an assigned BOPEC or Thrift Holding Company composite rating of "2" or better; and,

- has at least 75% of its consolidated depository institution assets comprised of eligible depository institutions.

An "**eligible depository institution**" is one that: **(1)** has a composite rating of "1" or "2", **(2)** has a compliance rating of "1" or "2", **(3)** has a Satisfactory or better CRA rating, **(4)** is well-capitalized as defined by the appropriate capital regulations of its primary federal regulator, and **(5)** is not subject to any form of administrative agreement (such as an MOU, Cease and Desist Order, Prompt Corrective Action, etc.) with its primary federal regulator or chartering authority. The definition of administrative agreement generally excludes a Board Resolution for <u>minor</u> supervisory matters. However, an application can be removed from expedited processing for various reasons, including, but not limited to the following:

a) Safety and soundness concerns of the Department dictate a more comprehensive review;

b) Any material adverse comment is received by the Department;

c) Other supervisory concerns, legal issues, or policy issues come to the attention of the Department;

d) If applicable, any acquisition of fixed assets would cause the institution to exceed the state fixed asset limitation; or

e) Any other good cause exists for denial or removal.

## CRITERIA FOR EXPEDITED PROCESSING FOR ONE BANK HOLDING COMPANY FORMATIONS

1. The shareholder or shareholders who control at least 67% of the shares of the bank will control, immediately after the reorganization, at least 67% of the shares of the holding company in substantially the same proportion, except for changes in shareholders' interests resulting from the exercise of dissenting shareholders' rights under state or federal law;

2. No shareholder or group of shareholders acting in concert will, following the reorganization, own or control 10% or more of any class of voting shares of the BHC unless that shareholder or group of shareholders was authorized by the Department and the appropriate federal banking agency for the bank, to own or control 10% or more of any class of voting shares of the bank;

3. The bank is adequately capitalized as defined in Section 38 of the FDI Act.

4. The bank has received at least a composite "1" or "2" rating at its most recent examination, in the event that the bank was examined;

5. At the time of the reorganization, neither the bank nor any of its officers, directors, or shareholders is involved in any unresolved supervisory or enforcement matters with any appropriate state or federal banking agency;

6. The company demonstrates that any debt that it incurs at the time of the reorganization, and the proposed means of retiring this debt, will not place undue burden on the holding company or its subsidiary on a pro forma basis;

7. The holding company would not, as a result of the reorganization, acquire control of any additional bank or engage in any activities other than those of managing and controlling banks; and

8. In addition, the Department may deny or remove from expedited processing, any institution's application where it finds that:

    a) Safety and soundness concerns of the Department dictate a more comprehensive review;

    b) Any material adverse comment is received by the Department;

    c) Other supervisory concerns, legal issues, or policy issues come to the attention of the Department;

    d) Any other good cause exists for denial or removal.

In this event, the institution will be notified that expedited processing is not available, the reason, and instructions as to how to proceed.

# CRITERIA FOR EXPEDITED PROCESSING FOR BANK HOLDING COMPANY ACQUISITIONS

1. Well-capitalized organization.

a) Bank holding company (BHC). Both at the time of and immediately after the proposed transaction, the acquiring BHC is well capitalized as defined in the appropriate capital regulation and guidance of the institution's primary federal regulator.

b) Depository institutions. Both at the time of and immediately after the proposed transaction:

i) The lead depository institution of the acquiring BHC is well capitalized;
ii) Well-capitalized depository institutions control at least 80% of the total risk-weighted assets of depository institutions controlled by the acquiring BHC; and
iii) No depository institution controlled by the acquiring BHC is undercapitalized.

2. Well-managed organization.

a) At the time of the transaction, the acquiring BHC, its lead depository institution, and depository institutions that control 80% of the total risk-weighted assets of depository institutions controlled by the BHC are well managed, have received "satisfactory" or better composite ratings at the most recent examination.

b) No poorly managed institutions. No depository institution controlled by the acquiring BHC has received a "4" or "5" composite rating at the institution's most recent examination by the state or federal regulator.

c) Recently acquired institutions excluded. Any depository institution that has been acquired by the BHC during the 12 month period preceding the date on which written notice is filed may be excluded from the preceding paragraph if:

i) The BHC has developed a plan acceptable to the Department for the institution to restore the capital and management of the institution; and

ii) All depository institutions excluded under this paragraph represent, in the aggregate, less than 10% of the aggregate total risk-weighted assets of all depository institutions controlled by the BHC.

3. Convenience and needs criteria.

a) Effect on the community. The record indicates that the proposed transaction would meet the convenience and needs of the community standard in O.C.G.A. **§ 7-1-606(b)** or the BHC Act; and

b) Established CRA performance record. At the time of the transaction, the lead depository institution of the acquiring BHC and depository institutions that control at least 80% of the total risk-weighted assets of institutions controlled by the BHC have received a satisfactory or better composite rating at the most recent CRA examination.

4. Public comment. No comment that is timely and substantive as provided in O.C.G.A. **§ 7-1-606(d)** is received by the Department or other regulatory agency other than a comment that supports approval of the proposal.

5. Competitive criteria. Without regard to any divestitures proposed by the acquiring BHC, the acquisition does not cause:

a) Depository institutions controlled by the acquiring BHC to control in excess of 35% of market deposits in any relevant banking market; or

b) The Herfindahl-Hirschman index to increase by more than 200 points in any relevant banking market with a post-acquisition index of at least 1800.

6. Size of acquisition.

a) Limited growth. Except as provided below, the sum of the aggregate risk-weighted assets to be acquired in the proposal and the aggregate risk-weighted assets acquired by the acquiring BHC in all other qualifying transactions does not exceed 35% of the consolidated risk-weighted assets of the acquiring BHC. For purposes of this paragraph "other qualifying transactions" means any transaction approved under Section 225.14 or 225.23 during the 12 months prior to filing the notice; and

b) Individual size limitation. The total risk-weighted assets to be acquired do not exceed $7.5 billion;

c) The limited growth section shall not apply if, immediately following consummation of the proposed transaction, the consolidated risk-weighted assets of the acquiring BHC are less than $300 million.

7. Supervisory Actions. During the 12 month period ending on the date on which the BHC proposes to consummate the proposed transaction, no formal administrative order, including a written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, asset-maintenance agreement or other formal enforcement action, is or was outstanding against the BHC or any depository institution subsidiary of the BHC, and no formal administrative enforcement proceeding involving any such enforcement action, order, or directive is or was pending.

8. In addition, the Department may deny or remove from expedited processing, any institution's application where it finds that:

   a) Safety and soundness concerns of the Department dictate a more comprehensive review;

   b) Any material adverse comment is received by the Department;

   c) Other supervisory concerns, legal issues, or policy issues come to the attention of the Department;

   d) Any other good cause exists for denial or removal.

In this event, the institution will be notified that expedited processing is not available, the reason, and instructions as to how to proceed.

# BANK CHARTERS

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It is the policy of the Department to maintain a sound banking system without placing undue restraint upon entry into that system. The vital relationship of banking to the monetary system precludes complete free market operation with unlimited entry, and its corollary, unlimited exit. A healthy competitive banking environment providing optimum choice and convenience to the public and stimulating economic growth and efficiency is an important objective of the chartering process. Although each new entrant to the market increases the competitive alternatives, it is not in the public interest to charter so many banks that none can grow to a size sufficient to offer a full range of needed services. In chartering banks the Department will admit only those qualified applicants that can be economically supported and profitably operated. In evaluating a new bank application, the following factors will be considered:

<u>FINANCIAL HISTORY AND CONDITION</u>. Only in certain special situations would a de novo bank charter have financial history. The main areas to be considered in analyzing this factor are the reasonableness and achievability of the submitted Business Plan and the premises and other fixed assets to be owned or leased by the proposed bank. The minimum size of the proposed building should be at least 6,000 square feet. Any proposal with less than this size may be approved but must be substantiated as to adequacy in the application. Generally, if the applicant intends to outsource some or all of its backroom operations, the de novo bank may be able to operate in a smaller facility.

<u>CAPITAL</u>. The minimum initial capital required for a new bank must satisfy all of the following factors:

- X Capital should be sufficient to support the anticipated volume and character of operations for a minimum of three years; total capital must be adequate to meet three-year projected needs resulting in a Tier 1 capital-to-assets leverage ratio of at least eight (8) percent. If the applicant is being established as a wholly-owned subsidiary of an existing bank holding company, the Department will consider the financial resources of the parent organization as a factor in assessing the adequacy of the proposed initial capital injection. Provided the Department determines that the bank holding company will be a source of financial strength for the new bank, some flexibility may be allowed in meeting the three year capital requirement. In such cases, the Department may find favorably with respect to the adequacy of the capital factor provided:
    1. The holding company shall provide a written commitment to maintain the proposed institution's Tier 1 leverage capital ratio at no less than 8 % throughout the first three years of operation, and the Department must determine that the holding company has the financial capacity to honor that commitment.

    2. The initial capital injection is sufficient to provide for a Tier 1 leverage capital ratio of at least 8% at the end of the first year of operation, based on a realistic business plan.

- X Capital should be adequate to enable the new bank to provide the necessary banking services, including loans of sufficient size, to meet the needs of prospective customers.

- X Capital should be sufficient to purchase, build or lease a suitable permanent banking facility and equipment. Total fixed asset investment should not exceed sixty percent of the Statutory Capital Base.

State law requires that the **capital stock** component of total equity capital for newly chartered banks be not less than \$3,000,000. If the main office is to be located in a county with a population of less than 200,000 as of the most recent United States census, the minimum shall be \$2,000,000. In practice, greater amounts of capital (stock) have historically been required, depending upon the location and the particulars of the charter application. In addition to the above minimum levels of capital stock, Georgia law requires that the bank have paid-in capital in an amount not less than twenty percent (20%) of capital stock and an expense fund in an amount set by the Department which shall not be less than five percent (5%) of capital stock. Realistically, the expense fund should be adequate to cover pre-opening expenses and projected losses in the first three years of operation.

The ability of a bank to attract capital funds for future growth is important to the chartering process. It will generally be assumed that a broad and diverse group of stockholders providing the initial capitalization of the bank will maintain the capital funding at adequate levels. Smaller or concentrated shareholder groups will be required to demonstrate their ability to support the capital funding needs of a growing bank through a broad range of economic circumstances.

During the first three years of operation, cash dividends shall be paid only from net operating income and shall not be paid until an appropriate allowance for loan and lease losses has been established and overall capital is considered adequate. The adequacy of overall capital should be determined in accordance with the Department's Policy Statement on "Capital Adequacy for Financial Institutions" contained herein.

STOCK DISTRIBUTION. To enhance community support, the Department encourages a broad and diversified shareholder base for a new bank. However, the Department recognizes that in some instances the organizing group may wish to limit the number of shareholders due to certain tax considerations or for other purposes. In such situations the Department may approve the charter provided the limited shareholder base does not adversely affect the benefits of the new charter for its proposed market area and provided the applicant demonstrates adequate support for the bank in the proposed market area by means other than a diverse shareholder base. Generally, at least 50% of the stock to be issued should be to local residents of the community, or persons with substantial business interests in the community or others who may reasonably be expected to utilize the services of the bank.

Subscribers to 10% or more of the stock, proposed officers, and all directors irrespective of the level of their subscription may finance, in the aggregate, more than 50% of the purchase price and individually more than 75% of the purchase price, provided supporting justification is furnished in the application establishing these financing arrangements as acceptable. The burden of proof of stock financing arrangements which exceed 50% aggregately and 75% individually rests with the above parties. These financing arrangements are arrangements that are secured or predicated in any manner upon the stock purchased; therefore to the extent that other collateral is securing these obligations, this collateral value may be netted against the loan amount for determining if these limits are being exceeded. If the arrangements are not considered appropriate, the adequacy of capital structure requirement in the charter application may be found by the Department to be unacceptable.

The bank may not make a loan or refinance any loan associated with the initial purchase of bank or holding company stock after a permit to begin business is granted by the Department. If the arrangements are not considered appropriate, the Department may find the bank's capital structure (at application or once the bank has opened for business) to be unacceptable.

Stock subscriptions are considered a measure of community need and support for a new bank. An applicant that is unable to provide such broad and diverse stock subscribers as would normally be expected relative to the size of the community in which the new bank is to be located must be prepared to demonstrate the community need and support by other means.

Section **7-1-391**, O.C.G.A., prohibits the payment of any fee, compensation, or commission for promotion in connection with the organization of a new bank. This restriction does not impair the payment of reasonable compensation to attorneys, accountants, or consultants for services rendered in connection with the preparation and filing of an application or the payment of out-of-pocket expenses incidental to the preparation of an application and other matters necessary and incidental to preparations toward commencing business as a bank. Person(s) not otherwise involved or affiliated with the bank during its organization, who are utilized to locate purchasers of stock and who charge a fee for such service shall not be considered promoters and such expenses shall be considered usual and ordinary in the organization of a new bank. All such expenses must be fully documented and commensurate with local market prices for similar services and products. Representation before the Department for compensation may only be through a practicing attorney, public accountant, or full time bank consultant practitioner.

Use of Consultants to Raise Bank Stock

The Department strongly recommends community bank organizing groups attempt to sell the proposed bank's stock on their own rather than utilizing third party consultants. This recommendation reflects our experience that most banks have been able to successfully sell bank stock within their community and also reflects our concern regarding the expenses associated with many of these programs. It is noted that some groups that have experienced difficulty in selling stock have utilized such consultants to assist them in finalizing the stock sale.

It has been our observation that the fees assessed for these services appear to have been increasing at a substantial rate, with fees noted as high as three to four percent of the total stock issue, net of organizer stock. This could result in fees of $300,000 to $400,000 on a capital issuance of $12,000,000. This is in addition to the normal consultant fees paid for preparation of the charter application.

In most cases, these third party stock sale arrangements depend heavily upon the organizers' contacts within the community to facilitate stock sales, which again raises questions as to whether such arrangements reflect the most efficient use of bank capital.

While the fees are certainly not the only consideration in making such a business decision, the board of directors should carefully consider their duty to act as responsible stewards of the shareholders funds. Fees of this magnitude could be utilized to hire full time bank employees that could be utilized not only to sell stock, but also for business development, policy formulation and other tasks necessary to organize a bank.

The Department recommends that organizing groups carefully consider the implications of using a stock sales consultant and review all options before utilizing an outside consultant to assist the bank in the stock sale. Banks that utilize outside consultants in facilitating the stock sales can anticipate the following responses from the Department:

1. We will indicate at our prefiling meeting that it is our clear preference that community bank organizing groups make an effort to sell their own stock within their community. If the organizers and operating management of the bank are properly composed, it has been our experience that there should not be difficulty in the sale of bank stock.

2. If an organizing group determines to utilize a marketing arrangement, then they should expect the amount of capital that will have to be raised to be higher than if such an arrangement is not utilized. The additional amount of capital will depend on the business plan of the bank, but could be a substantially greater amount.

3. If an organizing group determines to utilize such an arrangement, the Department will require the Board of Directors to adopt a resolution indicating that they desire to utilize the services of a consultant in the sale of bank stock. Each Board member should attest to having reviewed all contract terms to be utilized in such an arrangement, including the fees for these services.

4. The Department considers the fees contracted between bank consultants and organizing groups to be a business decision of the prospective organizers, however we reserve the right to require any contract terms that are considered detrimental to the interests of a bank or its shareholders to be omitted from the contract or revised.

5. The Financial History and Condition Factor in the application process does require the Department to consider the reasonableness of aggregate fees paid to outside consultants. The Department has preferred to permit the organizers to utilize their business judgment in such matters. If we determine that the amount of proposed fees for the services that are being provided are abusive or contrary to the interests of the bank, then this can impact the decision of the Department to grant a bank charter.

6. The Department will continue to review the shareholder listings for denovo community banks to make certain that shareholder composition reflects adequate community support for the success of the proposed bank.

<u>Investment in Community Banks by Investment Funds</u>

As stated previously, the Department expects at least 50 percent of the proposed bank's stock should be owned within the trade area of the bank. Any investment in the proposed community bank by investment funds should represent a relatively small percentage of total stock holdings; not greater than 10 percent of the stock on an aggregate basis. One of the factors in the decision to charter a new bank is a clear indication that there is tangible community support for a bank. If a prospective bank is unable to sell their stock within the community but instead has to raise capital from outside investment funds, it raises a concern regarding whether an additional bank charter is needed in the proposed trade area. Any denovo bank that proposes to have an alternative capital structure or composition should discuss this with the Department prior to filing their bank application.

NOTE: The forgoing limitation on aggregate investment by investment funds is for community banks. Larger banks with broader business plans, greater levels of capital and more sophisticated management may have higher levels of such investment, with regulatory approval.

<u>Stock Benefit Plans</u>

Stock benefit plans established to compensate incorporators in connection with the organization of a bank including stock options, stock warrants, or other stock based compensation plans may be appropriate if the plans enhance the success of the bank and can be justified as reflective of the contributions made to the bank. If a bank holding company is being organized simultaneously with the organization of a new bank and stock benefit plans are established at the bank holding company, similar rules and conditions regarding these stock benefit plans would apply. These stock benefit plans must be fully disclosed in the application filed with the Department and subsequent offering material used in stock subscription solicitations. Original Articles of Incorporation must provide for sufficient shares without preemptive rights to meet such stock benefit plans.

Stock benefit plans issued to directors of the bank/ holding company shall contain the following minimum terms:

1. Must be exercised within ten years from the date of the bank's incorporation;

2. Must be exercised at a price equal to or in excess of the fair market value of the stock at the time the rights are granted;

3. May not result in the holder (including shares owned by the holder's spouse and minor children) owning more than 20% of the outstanding stock of the institution, unless the Department has approved the holder owning more than 20% of the outstanding stock of the institution in the approval of the bank’s charter application;

4. May be granted only to persons named as incorporating directors (plus the proposed chief executive officer if accorded confidential treatment in the application) in the original Articles of Incorporation;

5. Must contain a provision allowing the institution’s primary state and/or federal regulator to direct the institution to require plan participants to exercise or forfeit their stock rights if the institution’s capital falls below the minimum requirements, as determined by its primary state or federal regulator;

6. May not be transferable under any circumstances.

7. Must be accounted for in accordance with Generally Accepted Accounting Principles including the provisions of FAS 123R.

Stock benefit plans issued to other incorporators as compensation for financial risk borne during the organizational phase or as compensation for professional or other services rendered in conjunction with the organization shall contain the following minimum terms:

1. Must serve as compensation for services rendered or money placed at risk during the organizational phase of the bank;

2. Must be exercised within ten years from the date of the bank's incorporation;

3. Must be exercised at a price equal to or in excess of the fair market value of the stock at the time the rights are granted;

4. May not result in the holder (including shares owned by the holder's spouse and minor children) owning more than 20% of the outstanding stock of the institution, unless the Department has approved the holder owning more than 20% of the outstanding stock of the institution in the approval of the bank’s charter application;
5. Must contain a provision allowing the institution’s primary state and/or federal regulator to direct the institution to require plan participants to exercise or forfeit their stock rights if the institution’s capital falls below the minimum requirements, as determined by its primary state or federal regulator.

6. Must be accounted for in accordance with Generally Accepted Accounting Principles including the provisions of FAS 123R.

EARNINGS. Projections of income and expenses of the proposed bank should be based on realistic, supportable estimates of deposit and loan volume. While initial operating losses may be expected, net earnings should result in a month-to-month operating profit which is adequate to support the bank by the end of the third year.

MANAGEMENT. Organizers, proposed directors, and officers should be of good moral character and reputation, should have employment and business histories demonstrating success, and should be responsible in personal and financial affairs. A majority of the organizers and directors of a proposed bank must be from the local community and should represent a diversification of occupational and business interests. Officers should have demonstrated abilities and experience commensurate with the position for which proposed. Members of the initial management group, which includes directors and officers, and changes within the management group during the first two years of operation, require prior approval of the Department. The name and a resume' on the proposed chief executive officer must be submitted with all applications. To protect current employment, such information may be included in the confidential section of the application. The proposed chief executive officer (CEO) should have been continuously employed in a commercial bank for the five years immediately preceding the filing of the application and must demonstrate proven competence in the areas of bank administration and either bank operations or direct commercial lending. The Department prefers that the proposed CEO has previous experience as a bank CEO; however, the Department may approve a strong candidate without previous CEO experience if that candidate is supported by a strong Senior Lender and a strong Chief Operations Officer. Successful charter applicants will be required to obtain Department approval prior to commencing business for the one or more additional officer candidates. It is expected that these officers will augment the experience of the chief executive officer such that the resultant management team shall demonstrate proven competence in the areas of bank administration, commercial and consumer lending, bank operations, and investment/funds management.

All proposed directors, including the chief executive officer, and all non-director stock subscribers to ten percent or more of the proposed capital stock shall file financial and biographical information on forms prescribed by the Department including supplemental reports relative to all equity interest which constitute more than ten percent of their individual net worth. The applicant group shall provide the Department with personal, independent credit reports on each of the foregoing individuals as part of the financial and biographical information. Persons subsequently proposed to be added to the board and any new chief executive officer employed during the first two years after the granting of the charter or subscribing to 10% or more of the initial capital stock issue shall be required to make similar filings and be approved by the Department prior to their taking office or being issued any stock. Such persons shall also provide written consent for the Department to conduct appropriate investigation for possible criminal misconduct through the Georgia Bureau of Investigation and the Federal Bureau of Investigation.

### Executive Officer Compensation in De novo Banks

In order to provide for safe and sound compensation practices for executive officers, bank management shall provide to the Department a Compensation Policy that shall, at a minimum, reflect the maximum proposed compensation for senior bank officers, including core compensation, signing bonuses, other bonuses or incentive compensation features and other forms of compensation including deferred compensation, ESOP's, 401K payments or any other form of executive compensation provided to these officers. Expense items paid by the bank that reflect expenses paid that would, under normal circumstances, have to be paid by the individual bank officer would be included in the definition of compensation.

The total level of compensation shall be demonstrated to be reasonable based upon the business plan of the bank, normal and customary levels of compensation within the industry taking into consideration geographic and competitive factors, the asset quality of the financial institution, the capital level of the bank and the operations and profitability of the bank.

The Compensation Policy should be forwarded at the time of the application filing, so that it can be thoroughly reviewed during the application process. Note that compensation that is not considered reasonable based on the criteria above may be grounds for the disapproval of an application or may result in the modification of the application to meet safety and soundness requirements. The Department will be looking to make certain that compensation formulas consider bank performance and are predicated on maintaining creditworthy bank assets. Please also note that proposed compensation levels and practices are subject to FDIC approval, relative to the decision to grant Federal deposit insurance.

### Bank Directors Serving as Members of the Operating Management of the Bank

The Department has concerns regarding de novo bank proposals which involve providing members of the board of directors with an office in the bank, and in some cases allowing them to draw a salary for being a part of bank management. Unless this individual is an experienced banker (a previous CEO, bank lender, operational officer or CFO with appropriate experience), the Department believes that this structure is counterproductive to the success of a de novo bank. Some concerns noted with the practice are as follows:

This arrangement often creates uncertainties regarding the authority of the CEO and other management and has resulted in excessive management turnover in several charters. This can be seriously disruptive to any bank and has been noted to impede and delay bank profitability in de novo banks.

This arrangement in some cases has resulted in a circumvention of normal credit approval practices and has resulted in attempts by certain board members to push through loans which don't meet the standard underwriting criteria of the bank. Directors should be involved in the credit process through the establishment of loan policies and through their appropriate involvement on the loan committee.

Salaries in de novo institutions are a particular concern. Most de novo institutions don't have the ability to pay salaries to anyone unless those salaries can be demonstrated to be accretive to the bottom line of the bank. Paying substantial salaries to directors serving as business development officers or other similar positions is a concern. Several situations observed involved salaries near or even above the level of the CEO. The Department reserves the right to determine that such a salary is inappropriate during the de novo period based on the needs of the bank and the services proposed to be provided.

We believe these arrangements have fostered other inappropriate practices with directors in certain cases including non-arm's length business transactions, inappropriate bank expenditures, inappropriate usage of bank vehicles and other objectionable practices.

These practices (if not included in the business plan filed with the application) are considered to be a substantive modification of the business plan, requiring the approval of the Department and the FDIC. This is another basis for the Department objecting to this practice.

Additionally, we believe this practice, particularly in a bank with below peer earnings performance, could constitute a basis of action by shareholders since it could be alleged in some cases that these arrangements represented self-dealing or were otherwise not representing the best interests of shareholders.

The Department will continue to review the merits of all proposals and practices on a case by case basis, but will generally disallow these practices during the de novo period for any bank which failed to include these provisions in the bank's application and business plan filed with the regulators and in the prospective materials provided to the shareholders. In cases where these practices are included in these documents, the Department may still determine that these practices are not appropriate where a case cannot be demonstrated that they make sound business sense for the bank and serve the best interest of all shareholders.

The Department is considering such limitations during the de novo period of the bank, which is normally the first three years of operations of the bank or the period until the bank reaches cumulative profitability, which ever is longer. After this period elapses, it will be a business decision of the Board to determine if this practice is appropriate (but the above concerns remain unless this individual can be demonstrated to be an experienced banker or that these arrangements are otherwise demonstrated to be a sound business decision.) Also it should be noted that the Department permits the Board of Directors to establish director and committee fees at reasonable amounts, once the bank has reached cumulative profitability. We regard this issue to be a matter of sound corporate governance and properly meeting the fiduciary responsibilities of a bank director.

CONVENIENCE AND NEEDS OF THE COMMUNITY TO BE SERVED. The current economic condition or growth potential of the market in which the new bank proposes to locate is an important consideration in determining the bank's probable success. Essential to the concept of banking opportunity is that there does or will exist a volume of business for which the new bank can realistically compete. Also important is a determination of the portion of that business the new bank could acquire and whether that portion is sufficient to generate a profit. Where the de novo bank is purchasing and assuming the assets/liabilities of an existing branch(s), the amount of information required in support of the Convenience and Needs factor may be abbreviated since the bank would be replacing a competitor in the market.

Evidence of banking opportunity may be indicated in a number of ways including trends in population, employment, residential and commercial construction, sales, company payrolls and businesses established. Geographic and environmental restrictions to further development should be fully explored.

PRIMARY SERVICE AREA. Within the broader concept of a market, the applicant should delineate a Primary Service Area (PSA). The dimensions of the PSA will necessarily vary with the type of market to be served. A rural bank may serve a relatively large area if banking alternatives are limited; conversely, the PSA of an urban bank may be limited to several city blocks. The PSA is defined as the smallest area from which the bank expects to draw approximately 75% of its deposits and should be drawn around a natural customer base. It should not be unrealistically delineated to exclude competing banks or to include areas of concentrated population. Barriers to access such as major highways, rivers, mountains or other impediments should be considered.

LOCATION. The importance of the specific site depends upon the type of market to be served. The precise location of a bank in a sparsely populated area with limited competition may be less significant than that of an urban or suburban bank whose success may be more dependent upon the convenience of its location.

POPULATION. Composition of the population, including daily or seasonal inflows, within the PSA is an important indication of the potential support for a bank. Population characteristics such as income, age distribution, educational level, occupation and stability should be considered. Ratios of population per banking office are not conclusive evidence of support for a new bank.

FINANCIAL INSTITUTIONS. The growth rate and size of banks and other financial institutions in the market are also important indicators of economic condition and potential business for a new bank. Location and services offered are indicative of the competitive climate of the market. Other financial institutions such as savings and loan associations, credit unions, finance companies, mortgage companies, and insurance companies may be considered competing institutions to the extent their services parallel those of the new bank.

CONSISTENCY OF CORPORATE POWERS. Normally a proposed bank is chartered for the purpose of performing all powers that a commercial bank is allowed under the law. If the bank has the word "Trust" in their name or anticipates exercising trust powers in the future, it must be chartered as a "bank and trust company" in the Articles of Incorporation. No bank may exercise trust powers other than those allowed for Individual Retirement Accounts, without the prior written approval of the Department.

ESTABLISHMENT OF A DE NOVO BANK BY A REGISTERED BANK HOLDING COMPANY. Pursuant to O.C.G.A. Section **7-1-608(b)(3)**, a bank holding company registered with the Department and owning a bank that does a lawful banking business in this state may acquire control through the formation of a de novo bank in Georgia, provided that Department approval and any required federal approvals are obtained. However, no out-of-state bank holding company may enter Georgia to do a banking business by formation of a de novo bank. Additionally, a de novo bank established or formed under the above Code Section shall be subject to the three-year age requirement contained in Section 7-1-608(a)(2) - which states that the bank being acquired must have been in existence or continuously operating or incorporated as a bank for a period of three years or more prior to the date of acquisition. A bank holding company may, however, merge or consolidate a de novo bank which may be less than three years old, established pursuant to Section 7-1-608(b)(3), into another bank owned by that holding company.

Notwithstanding the foregoing, affiliation shall be disallowed whenever the performance of the sponsoring bank has been found to be unacceptable. Further, the performance of the sponsoring bank shall be considered in assessing the MANAGEMENT FACTOR on the de novo application.

Management or consulting contracts between the affiliated bank/bank holding company and the de novo bank shall be assessed for equitable pricing, affordability, and controlling influences. Contractual services purchased from the affiliate must be supported by competitive bids or other similar evidence that compensation is no greater than that provided by independent providers of comparable services or products.

HOLDING COMPANY FORMATION. If a holding company is anticipated at the time of application of the proposed bank, it is appropriate for the applicant to submit the holding company application to the Department and the Federal regulator thirty (30) days after the charter application has been submitted. The applicant should, however, indicate in the charter application their plan to form a holding company and state that the application is forthcoming. No additional fee will be required if the holding company application is filed within 120 days of the filing of the charter application.

OTHER FACTORS. The organization of a new bank is normally begun to serve a demonstrated need for new or additional banking services in a specific community. An application for a proposed new bank will not be approved by the Department if its establishment would threaten the viability of a newly chartered bank. Such protection of a newly chartered bank typically will not exceed one year.

From time to time, specialized forms of banking activity which are not directed at the retail or community level are developed and the Department reserves the right to modify the policies and provisions set forth herein in order that the entire economy of this State may be adequately served at both the wholesale and retail levels. Organization of a new bank for speculative purposes or resale to undisclosed buyers is not permitted.

IMPORTANCE OF FILING PRIORITY IN THE EVENT OF CONFLICTING APPLICATIONS. The Department's Statement of Policies indicates that priority of filing ordinarily will not be a factor in the decision-making process relative to matters before the Department when two or more applications are pending concurrently from different applicants. The Department's first obligation is to see that each activity proposed is in compliance with the laws, regulations, and policies applicable to that situation. Where only one application can be implemented and the choice rests ultimately with a bank's management or its shareholders, the Department will normally defer the selection to that group. However, where the selection must be made between conflicting applications by the Department and no clear priority of one application over another exists, the Department shall exercise its discretion in favor of the application which it perceives to be most favorable to the delivery of quality financial services to the community to be served. Absent a substantial difference in the quality of prospective financial services or the proposed delivery system, and where a priority is clearly established, deference shall be given on the basis of such priority. Priority shall be determined on the basis of one or more of the following factors:

a) Completion of Preliminary and Final Documentary filings.

b) Preliminary meetings with the Department to discuss the transaction and incidental applications, investigations, and approvals.

c) Employment of outside consultant services utilized in completing applications and expenditure of other significant out-of-pocket funds incidental to the filing of an application.

d) Publication of Public Notices.

The Department recognizes that applications and decisions leading up to the filing of an application in today's regulatory environment may require a substantial outlay of funds without any assurance of final approval. It is also recognized that careful and deliberate research, study, and consideration of alternatives is the best avenue to achieve a successful operation. Accordingly, an applicant which has out of caution, prudence, or other motivation elected to expend such time and money to insure a greater probability of success in their decision making process should not be disadvantaged relative to a conflicting application which has been ill-conceived or hastily prepared simply to establish priority in the regulatory process. **Priority of filing ordinarily will not be a factor in the decision-making process.**

All expenses incurred in connection with the organization of a bank are to be assumed by the organizers. If a charter is issued, expenses determined to be reasonable by the Department may be reimbursed by the bank after the commencement of business. In no event shall the amount of or payment of any fee be solely contingent upon action, decision, or forbearance on the part of the DBF. A contingent expense or fee will ordinarily result in disapproval of the application.

Any financial arrangement or transaction involving the proposed bank and its organizers, directors, officers, major shareholders or their associates or interests ordinarily should be avoided. If there are transactions of this nature, they must be fair, fully disclosed, reasonable and comparable to similar arrangements that could have been made with unrelated parties.

The name of the new bank will be considered in accordance with the Policy Statement for Title Changes.

The foregoing policy will generally not be applicable to a corporate reorganization or to proposals to organize a bank to facilitate the acquisition of any existing bank.

## PROCESSING PROCEDURES

PROCESSING. If the applicant meets the qualifying criteria outlined on Page 2 of this Manual, expedited processing procedures will be followed. If the applicant meets all of the expedited processing criteria, with the exception of the holding company size criteria, the application will still be processed in an expedient manner. In such cases, the applicant should discuss the proposal with the Department prior to submitting the application. If the application qualifies for expedited processing, the Department will act within 60 days of acceptance of the application, or the end of the public comment period, whichever is later. For all other bank charter applications, particularly where the applicant will be an independent bank, regular processing procedures will be followed. Typically, the Department will act with 90 days of acceptance of the application.

PUBLICATION REQUIREMENTS. Publication for public comment on the charter application may commence no sooner than five (5) days prior to the date the application is mailed or delivered to the Department. The form of publication may be joint with the federal regulator, if only one publication notice is desirable. The publication should be published in a newspaper of general circulation in the community in which the applicant's main office is or will be located and in which the applicant proposes to engage in business as notification to any interested parties of their right to protest the application.

A separate Publication of the Articles of Incorporation will have to be made, following acceptance of the Articles by the Department, in accordance with O.C.G.A. **§ 7-1-392.**

Persons desiring to organize a bank should obtain forms and instructions from the Department. Normally, the group of organizers will arrange a meeting with representatives of the Department and the primary federal regulator prior to receiving an application. Charter applications should be filed simultaneously with the Department and the primary federal regulator since all banks in the State of Georgia must have deposit insurance coverage.

Requests for reconsideration of disapproved applications will not be accepted. A new application may be filed at any time by submitting substantive new or additional information to the Department. To the extent relevant, the Department will consider and incorporate the prior administrative record. A supplemental filing fee will be required. When a charter application is disapproved, a written statement of the reasons for the disapproval will be furnished to the applicant.

The time allowed to open for business normally will be two years from the date of preliminary approval. Preliminary approval will be rescinded if the bank is not open for business within this two-year period.

# BRANCH OFFICE (ESTABLISH OR RELOCATE)

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The Department evaluates branch office applications or notifications to establish or relocate pursuant to O.C.G.A. § 7-1-602 and Rules 80-1-1-.06 and 80-1-1-.08. The Department considers the applicant's capacity to support the location of major importance when evaluating a branch office application. The judgment of the applicant as to the viability of a proposed branch office or relocation will ordinarily be granted deference, provided that, in the opinion of the Department, the applicant's capacity is sufficient or will be enhanced by the new activity. A relocation is applicable when the location of an existing banking location is to be moved to a new or additional location which is to be constructed, purchased, or leased within the same immediate vicinity of the existing branch. A bank which desires to relocate its main office to an already existing location can request that the Department consider the move as a redesignation rather than a relocation. Refer to the Redesignation of Branch and Main Office section of the Statement of Policy and the Applications Manual as well as Department Rule 80-1-1-.08. An application to establish or relocate a branch office will be assessed by the Department utilizing the Evaluation Factors detailed below.

Pursuant to Rule 80-1-15-.02, banks may provide unlimited banking services through mobile banking units that do not have a single, permanent site and use a vehicle that travels to various locations to enable customers to conduct banking business. Mobile branches are required to maintain logs indicating the specific locations and times in which the mobile unit is operating. Banks are required to publish the mobile unit schedule on their website. If a bank alters the approved banking service area, management must submit advanced notice to the Department. Since a mobile unit will function as a branch, application for approval is made through the branch approval process.

Banks that are not chartered by the Georgia Department of Banking and Finance are **not** required to file any branch application or notice with the Department. The appropriate application should be filed with the home state regulator or the Office of the Comptroller of the Currency, as appropriate.

<u>EVALUATION FACTORS</u>

<u>CONDITION OF THE APPLICANT</u>. The applicant's general condition should be satisfactory. Significant or serious problems will normally preclude approval. A bank should not have an undue amount of criticized assets (particularly in relation to capital), serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls, or other significant problems.

<u>CAPITAL AND EARNINGS</u>. Capital, earnings, and retention of earnings should be sufficient to support the current level of operations as well as the proposed expansion. In determining the applicant's capacity to support the proposed branch office, the estimated cost of establishing and operating the branch office and the volume and scope of anticipated business will be considered.

<u>CHARACTER AND FITNESS OF MANAGEMENT</u>. Management should have demonstrated the ability to supervise a sound banking operation. This determination will generally relate to the overall condition of the bank and management's ability to recognize and correct deficiencies. Depth and continuity of management are also relevant factors in considering the bank's capacity to expand through the establishment of branch offices.

<u>INSIDER INTERESTS</u>. Any financial arrangement or transaction involving the branch office and the bank or holding company's directors, officers, major shareholders, or their associates or interests should be exercised with caution. If insider transactions exist, they must be fair, approved by the full Board with abstention of the insider, fully disclosed in the application, reasonable, and compare to similar arrangements that could have been made with unrelated parties.

<u>FIXED ASSET LIMITATIONS</u>. Rule 80-1-10-.01 limits the amount of investment in fixed assets by a bank to a maximum of 60% of the bank's Statutory Capital Base, unless prior approval from the Department is granted to exceed this limit. The institution's investment in fixed assets will be reviewed for compliance with this statutory limit. If the fixed asset investment is in excess of this limit, the Department may consider corrective plans including immediately restructuring the capital accounts to comply with the 60% limit, or by the bank providing an orderly plan for restoring the fixed asset investments to the 60% limitation within five years, either through depreciation or predetermined plans to restructure the capital accounts to comply with the 60% legal limitation, or a combination of these methods.

PROCESSING PROCEDURES

Applicants qualifying for expedited processing should file a letter form notification with the Department. Details regarding the content of the letter form notification can be found in the Department's Applications Manual.

A bank desiring to establish or relocate a branch office which does not meet the expedited processing qualifying criteria should obtain the "Branch Office Application" from the Department's website – http://dbf.georgia.gov. The Department will accept the Federal Regulator's application in lieu of the Department's application if the bank submits the application through secure e-mail. The bank is also required to electronically submit the filing fee to the Department.

If applicable, applicants will be advised of the reasons for disapproval. Requests for reconsideration of denied applications will not be accepted. A new application may be filed at any time if it contains substantively new or additional information. A supplemental filing fee will be required if expedited processing is not applicable.

The time allowed to open the branch office will normally be one year from the date of the approval; however, a one year extension of the original approval may be granted at the bank's request and the Department's discretion. In such cases, approval will be rescinded if business has not commenced within this two-year period.

# REDESIGNATION OF BRANCH AND MAIN OFFICE

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The Department evaluates redesignations pursuant to O.C.G.A. §§ 7-1-600 and 7-1-602 and Rule 80-1-1-.08. A redesignation is applicable when a branch office becomes a main office and the main office, if it is not closed, becomes a branch office. In the event the bank intends on closing the former main office as part of a redesignation, then the closing procedures for a bank location must be followed. If the main office is being relocated, the bank's Articles of Incorporation may have to be amended. A redesignation application will be assessed by the Department utilizing the Evaluation Factors detailed below.

## EVALUATION FACTORS

CONDITION OF THE APPLICANT. The applicant's general condition should be satisfactory. Significant or serious problems may preclude approval. A bank should not have an undue amount of criticized assets (particularly in relation to capital), serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls, or other significant problems.

INSIDER INTERESTS. Any financial arrangement or transaction involving the branch office and the bank or holding company's directors, officers, major shareholders, or their associates or interests should be exercised with caution. If insider transactions exist, they must be fair, approved by the full Board with abstention of the insider, fully disclosed in the application, reasonable, and comparable to similar arrangements that could have been made with unrelated parties.

FIXED ASSET LIMITATIONS. Rule 80-1-10-.01 limits the amount of investment in fixed assets by a bank to a maximum of 60% of the bank's Statutory Capital Base, unless prior approval from the Department is granted to exceed this limit. The institution's investment in fixed assets will be reviewed for compliance with this statutory limit. If the fixed asset investment is in excess of this limit, the Department may consider corrective plans including immediately restructuring the capital accounts to comply with the 60% limit, or by the bank providing an orderly plan for restoring the fixed asset investments to the 60% limitation within five years, either through depreciation or predetermined plans to restructure the capital accounts to comply with the 60% legal limitation, or a combination of these methods.

## PROCESSING PROCEDURES

The bank should file a letter form application with the Department for treatment as a redesignation. The application should include detail of the proposed redesignation including a narrative of the redesignation, description of the overall condition of the bank, anticipated costs, disclosure of insider interests, and calculation of the resultant level of fixed assets in relation to limitations.

If applicable, applicants will be advised of the reasons for disapproval. Requests for reconsideration of denied applications will not be accepted. A new application may be filed at any time if it contains substantively new or additional information.

## BRANCH OFFICE CLOSING

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The Department evaluates branch closings pursuant to O.C.G.A. § 7-1-110.1 and Rule 80-5-2-.03. The Department considers the permanent closing of a branch office to be primarily a business decision of management. Banks should review federal requirements for branch closings and consider possible effects on CRA compliance.

PROCESSING PROCEDURES

Pursuant to O.C.G.A. § 7-1-110.1 and Department Rule 80-5-2-.03, closing of a bank location requires the bank to post notice of the action at such location at least 30 days in advance. The bank must also disclose the closure on its website at least 30 days in advance of the intended action. Such notice shall be posted for at least 30 consecutive days. Within two days of posting the notices, the bank must forward to the Department a copy of the notices posted at the location and on the website along with a letter form notification that includes the following information: the bank location to be closed; a statement of the reason for the proposed closing and a summary of any supporting information; and the proposed closing date. If the actual closing date is different than the proposed closing date, the bank must inform the Department in writing within 15 days of the closing.

## EMERGENCY BRANCH OR MAIN OFFICE CLOSING

Bank offices directly affected by any impending or existing emergency or other catastrophe may close temporarily under the conditions set forth in O.C.G.A. § 7-1-111 and Rule 80-5-2-.02. Banks have the discretion to close business operations in the event of a natural disaster or other emergency, including situations where an emergency may be imminent. Regulations provide for management to exercise its own discretion, with notification to the Department, in closing any institution for one business day upon its determination that the safety of customers, employees, or assets would be in jeopardy due to civil disorder, fire, acts of God, or similar circumstances which render the institution unable to conduct business in a safe manner.

Office closings due to emergency situations should be communicated to the Department as soon as transmission is feasible. Furthermore, banks should make every effort to reopen as quickly as possible to address the needs of their customers.

# EXTENSIONS OF EXISTING BANKING LOCATIONS

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The Department evaluates extensions of existing banking locations pursuant to O.C.G.A. § 7-1-603, Rules 80-1-1-.07, and the applicable rules in Chapter 80-1-15. An approved banking location may have an extension which is not considered to be a branch or main office, at which banking activities may occur. Extensions include Automated Teller Machines (ATM), cash dispensing machines, point-of-sale terminals, and night depositories. In addition, an extension is permitted that is located within the boundary lines of a single contiguous area of property owned or leased by the bank and used as a banking location, or if it is within 200 yards of such banking location. Banking services may be performed at the extension.

## PROCESSING PROCEDURES

As defined in Rule 80-1-1-.07, no notification is necessary for an ATM, cash dispensing machine, point-of-sale terminal, or night depository. Refer to O.C.G.A. § 7-1-603 for a full definition of these extensions. Extensions that are located within 200 yards of the boundary lines of a single contiguous area of property owned or leased by the bank and used as a bank location as defined by O.C.G.A. § 7-1-603(d) require notification. All other extensions require an application. Refer to the Bank Applications Manual for specific requirements.

## REPRESENTATIVE OFFICES

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A representative office is an office established by a bank, bank holding company, or their subsidiaries for the purpose of conducting business activities other than a banking business. Certain activities that constitute a banking business are set forth in O.C.G.A. § 7-1-241. Funds may not be disbursed from and/or collected at a representative office. A representative office does not meet the definition of a branch office or main office. O.C.G.A. § 7-1-590 specifically identifies a loan production office and a trust production office as types of representative offices.

Pursuant to O.C.G.A. §§ 7-1-591 and 7-1-592, a Georgia state-chartered bank, bank holding company, or their subsidiaries may establish representative offices anywhere in this state following registration with the Department. Additionally, subject to any limitations or restrictions of the host state and upon registering the representative office with the Department, a Georgia state-chartered bank, bank holding company, or their subsidiaries may conduct activities at any representative office outside Georgia that are authorized by Georgia law or that are permissible for a bank chartered by the host state where the representative office is located, except to the extent such activities are expressly prohibited by the laws of this state or by any regulation or order of the commissioner applicable to the Georgia state-chartered bank and except where the activity is one that requires approval from the Department, in which case such approval must be secured.

Pursuant to O.C.G.A. § 7-1-592, a bank, a bank holding company, or their subsidiaries operating under the laws of a state other than Georgia or of the United States may establish representative offices anywhere in this state, provided that such bank or bank holding company conforms to the requirements of its primary regulator.

### PROCESSING PROCEDURES

Pursuant to O.C.G.A. §§ 7-1-591 and 7-1-593, a bank, a bank holding company, or their subsidiaries domiciled in this state shall register all representative offices with the Department through letter form registration. The "Registration of Representative Offices" form is located on the Department's website – http://dbf.georgia.gov. Examples of representative offices include a Loan Production Office, Deposit Production Office, and Trust Production Office. Refer to the Applications Manual for additional information. In the instance of a representative office closing, the procedures outlined in Rule 80-1-1-.08(12) must be followed.

# AUXILIARY SERVICES

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The Department evaluates auxiliary services pursuant to O.C.G.A. § 7-1-241 and the applicable rules in Chapter 80-1-15. Auxiliary services include messenger services, account service representatives, and school savings and banking education programs. An application for auxiliary services will be assessed by the Department utilizing the Evaluation Factors detailed below.

## EVALUATION FACTORS

CONDITION OF THE APPLICANT. The applicant's general condition should be satisfactory. Significant or serious problems may preclude approval. A bank should not have an undue amount of criticized assets (particularly in relation to capital), serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls, or other significant problems.

INSIDER INTERESTS. Any financial arrangement or transaction involving bank or holding company's directors, officers, major shareholders, or their associates or interests should be exercised with caution. If insider transactions exist, they must be fair, approved by the full Board with abstention of the insider, fully disclosed in the application, reasonable, and compare to similar arrangements that could have been made with unrelated parties.

## PROCESSING PROCEDURES

MESSENGER SERVICES. A messenger service may be established, provided it satisfies the conditions set out in Rule 80-1-15-.03. A letter form application is required for the establishment of messenger services. Refer to the Applications Manual for specific application requirements. The bank should also contact the appropriate federal regulator to determine if an application is required under federal law or regulation. If an application is required by the federal regulator, a copy of the federal application can be submitted to the Department to satisfy the letter form application requirement.

ACCOUNT SERVICE REPRESENTATIVES. Banks may provide for account service representatives to visit public events and commercial locations to provide limited services. These services may include opening deposit accounts and providing services incidental thereto; provided, access to such locations and facilities is available to other financial institutions on a nondiscriminatory basis as detailed in Rule 80-1-15-.04. A letter form application is required for the establishment of account service representatives. Refer to the Applications Manual for specific application requirements.

SCHOOL SAVINGS AND BANKING EDUCATION PROGRAMS. As provided in Rule 80-1-15-.05, banks may participate in school savings and banking education programs, where such programs: are (a) provided for minors in order to promote thrift or to provide banking and financial education; (b) supervised by a school official or an organization affiliated with the school; and (c) in a location where the bank would otherwise be authorized to have a branch as outlined in O.C.G.A. §§ 7-1-601 and 7-1-602. A letter form application is required for the establishment of school savings and banking education programs. Refer to the Applications Manual for specific application requirements.

If applicable, applicants will be advised of the reasons for disapproval. Requests for reconsideration of denied applications will not be accepted. A new application may be filed at any time if it contains substantively new or additional information.

# CONVERSIONS

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The Department evaluates conversions by a national bank or federal savings bank to a state bank pursuant to O.C.G.A. §§ 7-1-550 through 7-1-555. Approval of a charter conversion must be consistent with the basic objective of maintaining a sound banking system. An application to convert should not be motivated by supervisory pressures from other regulatory authorities. The proposed name of the converting bank will be evaluated in accordance with the Statement of Policies for Name Permission, Reservation, and Change.

## EVALUATION FACTORS

CONDITION OF THE APPLICANT. The applicant's general condition should be satisfactory. Significant or serious problems will preclude approval. A bank should not have an undue amount of criticized assets (particularly in relation to capital), serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls, or other significant problems.

CHARACTER AND FITNESS OF MANAGEMENT. Management should have demonstrated the ability to supervise a sound banking operation. This determination will generally relate to the overall condition of the bank and management's ability to recognize and correct deficiencies.

## PROCESSING PROCEDURES

An institution desiring to convert to a state bank should contact the Supervision Division. The Department typically meets with members of senior management and the Board of Directors prior to the bank filing the conversion application.

To the extent considered necessary, the Department will conduct an investigation to evaluate the condition of the applicant. If the conversion is approved, the Department will issue a Certificate of Approval. Various conditions to the approval may also be imposed in a letter accompanying the Certificate of Approval based on the results of the investigation and discussions with management. If approved, the applicant must convert within six months of the approval date unless the Department grants an extension.

Pursuant to O.C.G.A. § 7-1-555, converting banks are authorized to only engage in lines of business, activities, exercise powers, or hold assets permissible by Department laws and rules; however, if the converting institution holds assets, engages in any business, activity, or has powers not allowed for a state bank, then the Department shall review a conversion plan to determine whether the activity, power, asset, or line of business should be approved, denied, or phased out within a reasonable period of time.

If applicable, an applicant will be advised of the reasons for disapproval. Requests for reconsideration of a denied application will not be accepted. A new application may be filed at any time if it contains substantively new or additional information. A supplemental filing fee will be required.

# BANK MERGERS

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The Department evaluates mergers pursuant to O.C.G.A. §§ 7-1-530 through 7-1-537; 7-1-620 through 7-1-626; and 7-1-628 through 7-1-628.15. It is the policy of the Department to preserve the soundness of the banking system and promote market structures conducive to competition. Upon compliance with the applicable merger requirements of Title 7 and other applicable laws and regulations, including any branching and minimum age laws and regulations, one or more banks or trust companies may merge or consolidate, provided that an institution exercising trust powers alone may merge or consolidate with a bank only if the bank is the surviving entity. A proposed merger, consolidation, or purchase of assets and assumption of liabilities (all hereinafter referred to as mergers) which appears to have a substantially adverse effect on existing or potential competition cannot be approved unless the public benefit clearly outweighs the anti-competitive effects of the proposed merger. A merger which does not appear to have a substantially adverse effect on competition and which appears beneficial to the merging financial institutions and the public, normally will be approved if the Evaluation Factors detailed below are deemed satisfactory.

If the name of the resulting financial institution is not the same as any of the financial institutions involved in the merger, the proposed name will be evaluated in accordance with the Statement of Policies for Name Permission, Reservation, and Change. If the merger involves holding companies, Bank Holding Company Formations and Acquisitions policies and applications will also apply.

## EVALUATION FACTORS

CONDITION OF THE APPLICANTS. The resultant financial institution's general condition should be satisfactory. Anticipated significant or serious problems with the resulting financial institution will preclude approval. The resultant financial institution should not have an undue amount of criticized assets (particularly in relation to capital), serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls, or other significant problems.

CAPITAL AND EARNINGS. Capital, earnings, and retention of earnings should be sufficient to support the current level of operations as well as any proposed expansion.

CHARACTER AND FITNESS OF MANAGEMENT. Management should have demonstrated the ability to supervise a sound banking operation. This determination will relate to the overall condition of the bank and management's ability to recognize and correct deficiencies.

COMPETITIVE EFFECTS. Anticompetitive conditions resulting from a merger involving a dominant financial institution in a market and any other financial institution in the same market could be determined to have a substantially adverse competitive effect. When substantially adverse competitive effects exist, they must be clearly outweighed by the probable effects of the merger and comply with O.C.G.A. § 7-1-622(b)(2)(B). If substantially adverse competitive effects are not clearly outweighed by the public benefit and brought into compliance, the merger will be disapproved. The factors demonstrating a public benefit which may outweigh the anticompetitive effects of a merger potentially include the elimination of a failing, weak or stagnating financial institution, thereby strengthening the banking system; the achievement of economies of scale, including a better matching of source and need of funds, thereby providing the basis for improved customer service and financial institution earnings; and the extension of services not available from the merging financial institution and for which there is a clearly definable need.

## PROCESSING PROCEDURES

When a merger involves a national or state bank that is headquartered in Georgia merging into a Georgia state bank, O.C.G.A. §§ 7-1-530 through 7-1-537 apply to the transaction.

When a merger involves an out-of-state national bank, federal thrift, or state-chartered bank merging into a Georgia state bank, O.C.G.A. §§ 7-1-530 through 7-1-537; 7-1-620 through 7-1-626; and 7-1-628 through 7-1-628.15 apply to the transaction. The Department may conduct an examination into the condition of the national bank, federal thrift, or out-of-state bank to the extent deemed necessary. The cost of such examination shall be charged to the applicant in addition to the normal merger fee.

When a merger will result in a Georgia state-chartered bank merged into a non-Georgia state-chartered bank, the applicant is required to provide notification to the Department of filing of an application with the appropriate federal regulator no later than the date on which the application is filed. A copy of the application is required to be provided to the Department. Additionally, the applicant is required to provide satisfactory evidence of all required approvals from all relevant bank supervisory agencies prior to consummation of the merger. When no substantially adverse competitive effects are demonstrated and the conditions of O.C.G.A. § 7-1-534(c) are satisfied, the Department will provide written confirmation that the provisions have been satisfied.

If applicable, an applicant will be advised of the reasons for disapproval. Requests for reconsideration of a denied application will not be accepted. A new application may be filed at any time if it contains substantively new or additional information. A supplemental filing fee will be required.

## DISSENTER'S RIGHTS CREATING TREASURY STOCK

While it has been relatively rare that there have been any dissenting shareholders to merger transactions who have exercised their dissenter's rights pursuant to O.C.G.A. §§ 7-1-537 or 7-1-572 (incorporating by reference O.C.G.A. § 14-2-1302 of the Corporate Code), this has on occasion occurred. The question then arises as to what disposition should be made of shares so acquired. Under other provisions of the Corporate Code the normal procedure for corporations is to void the shares with appropriate reductions in the common stock and surplus accounts; however, these provisions of the Corporate Code are not applicable to banks.

O.C.G.A. §§ 7-1-537 and 7-1-572 constitute sufficient authority for the bank to acquire treasury stock when the Department has approved a merger transaction, but only where there has been strict adherence to the procedures outlined in O.C.G.A. § 14-2-1302. In such cases the stock, while legally acquired, is subject to the provisions of O.C.G.A. §§ 7-1-261(6), 7-1-288, 7-1-436(b) and 7-1-460(a)(4). Reading these sections together, the Code recognizes the situation whereby a bank may lawfully acquire its own shares through a merger transaction but there is no intent to allow indefinite retention of such shares. On the other hand, the Code does not provide guidance as to the disposition of the shares in the case of stock acquired as a debt previously contracted ("D.P.C") under O.C.G.A. § 7-1-263(2). Further, the stock cannot be automatically voided and considered authorized but unissued simply by completion of the merger transaction as in the case of corporations subject to the Corporate Code.

Divestiture of acquired stock will be required within six months of the date of acquisition and extensions can be requested. The bank has three alternatives for disposition of the stock: (1) petition the federal regulator and the State for permission to reduce their outstanding stock, (2) sell the stock, and (3) distribute the stock to shareholders as a dividend-in-kind.

Upon receipt of proper notice that a dissenting shareholder wishes to exercise dissenting shareholders' rights, the Department shall be promptly notified of such fact in writing. The Department's approval of the transaction shall be subject to reconsideration or the imposition of additional conditions based upon the effects of the bank's acquisition of such shares, its plans for disposition of the shares, and the financial impact of those transactions unless the application has already addressed such a contingency. The merger may not be consummated without further approval of the Department and the federal regulator after review of this matter. If the resulting bank is a holding company subsidiary, the Federal Reserve must be notified in addition to the bank's primary regulators.

# FIDUCIARY POWERS

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The Department encourages a banking structure capable of fulfilling local, regional and national needs for banking services. The establishment of fiduciary powers affords banks the opportunity to better serve the public by offering greater services, choice and convenience. Fiduciary powers are granted in accordance with the Financial Institutions Code of Georgia Annotated.

In evaluating an application for fiduciary powers, consideration will be given to the capacity of the applicant to support the proposed activity, the availability of competent trust personnel and the existence of sufficient business to achieve profitability.

## BANKING FACTORS

CONDITION. The applicant's general condition should be satisfactory, significant or serious problems will normally preclude approval. A bank should not have an undue amount of criticized assets, serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls or other significant problems.

CAPITAL AND EARNINGS. Capital, earnings, and retention of earnings should be sufficient to support the current level of operations, as well as the proposed expansion. In determining the applicant's capacity to support the proposed trust department, the estimated cost of establishing and operating the department and the volume and scope of anticipated business will be considered.

MANAGEMENT. Management should have demonstrated the ability to supervise a sound banking operation. This determination will generally relate to the condition and profitability of the bank and management's ability to recognize and correct deficiencies.

TRUST PERSONNEL. The proposed head of the trust department should have demonstrated abilities and experience commensurate with the proposed position. Directors and officers who will serve on trust committees should possess experience and knowledge in the trust and investment fields. The bank should have available the services of competent investment and legal counsel to advise on matters affecting the trust department.

## MARKET FACTORS

The applicant should demonstrate that the population and general economy of the market possess characteristics requiring fiduciary services. Composition of the population within the market is an important indicator of the potential support for a trust department. Population characteristics such as income, wealth, age, educational level, occupation, and stability will be considered.

In determining need, consideration should be given to the present fiduciary services available in the market. If fiduciary services are being offered, consideration will be given to the volume and character of the present trust business, together with the demand for additional services. Further, consideration will be given to any fiduciary services performed outside the market for customers in the applicant's service area which, because of convenience, might be brought to the applicant.

## PROCEDURES

Banks desiring to exercise fiduciary powers should obtain forms and instructions from the Department. Applications should be filed with the Department.

Requests for reconsideration of disapproved applications will not be accepted. A new application may be filed any time by submitting substantive new or additional information to the Department. To the extent relevant, the Department will consider and incorporate the prior administrative record. A supplemental filing fee will be required. The applicant will be advised of the reasons for any disapproval.

**Power to Act as a Fiduciary for Tax-Advantaged Savings Accounts for Medical Costs and Retirement Plans**

The Department encourages a banking structure that promotes products and service to benefit consumers. The benefits of offering tax-advantaged savings accounts to the bank's customers promote or encourage individuals to establish saving plans to meet future medical expenses or to plan for retirement income. There may be certain advantages to putting money into these accounts, including favorable tax treatment.

Insured Financial Institutions, not exercising trust powers, may act as trustee or custodian of Individual Retirement Accounts established pursuant to the Employee Retirement Income Security Act of 1974 (26 U.S.C. 408); Self-Employed Retirement Plans established pursuant to the Self-Employed Individuals Retirement Act of 1962 (26 U.S.C.401); Roth Individual Retirement Accounts and Coverdell Education Savings Accounts established pursuant to the Taxpayer Relief Act of 1997 (26 U.S.C. 408A and 530 respectively); Health Savings Accounts established pursuant to the Medicare Prescription Drug Improvement and Modernization Act of 2003 (26 U.S.C. 223), and other similar accounts without the prior written approval of the Department provided:

- The duties of the trustee or custodian are essentially custodial or ministerial in nature.
- The trustee or custodian is required to invest the funds from the above tax-advantaged savings plan, as authorized under the Internal Revenue Code only in its own time or savings deposits or other interest bearing deposit accounts.
- Only cash contributions may be accepted into the account and that investment option shall be limited to investments in its own bank deposit accounts.

A financial institution should adopt written policies and procedures and enter into written account agreements which incorporates the trust instrument or custodial agreement governing the account. The financial institution as trustee or custodian should adopt procedures to comply with all reporting requirements under the Internal Revenue Code for a tax-advantaged savings plan. Model Internal Revenue Service (IRS) forms are available on the IRS website, www.irs.gov , and the U.S. Treasury website, http://www.treas.gov/offices/public-affairs/hsa/forms/, may be used provided they are in compliance with the policies of the Department regarding the duties and responsibilities of the trustee or custodian and account investments. The forms should be reviewed by the financial institution's legal counsel prior to use.

## SUBSIDIARIES OF BANKS

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The Department considers an application for the establishment of a de novo banking subsidiary to be primarily a business decision of the applicant. An applicant's sole ownership or joint ownership with other banks of a company will be approved if the proposed activity is a part of the business of banking or incidental thereto and if the applicant has the capacity to support such expansion. However, if a bank or any of its subsidiaries proposes to acquire an existing business, the Department will also consider competitive factors similar to those set forth in the Policy Statement for Mergers. If the proposed activity triggers some type of licensing or registration with another regulatory/government agency, the bank should ensure that these requirements are fully complied with prior to the subsidiary conducting the proposed activity.

In evaluating an application, the following factors will be considered:

### BANKING FACTORS

CONDITION. The applicant's general condition should be satisfactory; significant or serious problems will normally preclude approval of an application to expand the bank's activities. A bank should not have an undue amount of criticized assets, particularly in relation to gross capital, serious or frequent violations of law, inadequate liquidity, adverse operating trends, poor internal controls or other significant problems.

CAPITAL AND EARNINGS. Capital, earnings, and retention of earnings should be sufficient to support the current level of operations as well as the proposed expansion. In determining the applicant's capacity to support the proposed subsidiary, the estimated cost of establishing or acquiring the proposed subsidiary, as well as the volume and scope of anticipated business, will be considered.

MANAGEMENT. Management should have demonstrated the capacity to supervise a sound banking operation. This determination will generally relate to the condition of the bank and management's ability to recognize and correct deficiencies. Management should demonstrate that provision has been made for personnel with sufficient expertise to supervise the proposed activities.

### OTHER FACTORS

The condition of the business to be acquired will be considered. The acquiring bank should have the capacity to correct any difficulties of the acquired business without undue strain on management or financial resources of the bank.

Georgia law, specifically O.C.G.A. Section 7-1-288, spells out certain limitations for a bank’s investment with respect to shares of stock or other capital securities of any corporation. A general limitation on the banks investment in a subsidiary is the lesser of 10% of the total assets of the bank or 100% of Statutory Capital Base of the bank; however, these limitations may be exceeded where the proposed subsidiary activity could be conducted directly by the bank. The Federal Regulatory agencies also have limitations on the investment in bank subsidiaries, including limitations under Section 23A of the Federal Reserve Act.

Any financial arrangement or transaction involving the bank subsidiary and directors of the bank, officers, major shareholders, or their associates or interests ordinarily should be avoided. If there are transactions of this nature, they must be fair, fully disclosed, reasonable and comparable to similar arrangements that could have been made with unrelated parties.

### PROCESSING PROCEDURES

A letter form application is required for the establishment or acquisition of a bank subsidiary. Details regarding filing procedures and the items to be included in the letter form application can be found in the Department’s Applications Manual.

The Applications Manual also contains information regarding the qualifying criteria for expedited applications. Applications qualifying for expedited treatment will generally be acted on at the earlier of an approval letter from the Department or within 10 business days from receipt of a complete application. Applications processed under regular procedures will normally be completed within 30 days of receipt of a complete application.

The Department customarily performs a desk review of the application and typically does not conduct a field investigation. However, if the Department determines that some form of investigation is necessary, the applicant shall pay for the cost of such examination.

Requests for reconsideration of disapproved applications will not be accepted. A new application may be filed at any time by submitting substantive new or additional information to the Department. To the extent relevant, the Department will consider and incorporate the prior administrative record. Applicants will be advised of the reasons for any disapproval.

## SUBSIDIARY ACTIVITIES

The enactment of the Gramm-Leach-Bliley Act (GLBA) has substantially changed the landscape of permissible banking activities, including activities that can be performed at the bank subsidiary level.

### Financial Subsidiaries

GLBA permits certain activities permitted for financial holding companies to be conducted in subsidiaries of a national bank called financial subsidiaries. Financial subsidiaries may engage in specified newly authorized activities that are financial in nature or activities that are incidental to financial activities, if the bank and the subsidiary meet certain requirements and comply with certain safeguards. The financial subsidiary activities include many of the activities which are authorized for new "financial holding companies" as detailed in Section 4(k) of the Bank Holding Company Act. Financial subsidiaries cannot engage in insurance underwriting (with some exceptions), real estate investment, real estate development or securities underwriting, investment banking or merchant banking where they maintain a passive equity interest in non-financial companies. They may conduct securities underwriting that does not meet the forgoing criteria.

A financial subsidiary of a state member bank may conduct only three types of activities: (1) Activities that have been determined to be financial in nature or incidental to financial activities and permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act of 1956 (These activities are listed in Section 225.86 of the FRB's Regulation Y); (2) Activities that the state member bank is permitted to engage in directly, subject to the same terms and conditions that govern the conduct of the activity by the state member bank; and (3) Activities that the Secretary of the Treasury determines to be financial in nature or incidental to financial activities and permissible for financial subsidiaries of national banks pursuant to Section 5136A(b) of the Revised Statutes of the United States (12 U.S.C. 24a(b)).

### Section 46 Activities

GLBA creates a new Section 46(a) of the FDI Act that provides that an insured state bank may control or hold an interest in subsidiary that engages **as principal*** in activities that would only be permissible for a national bank to conduct through a financial subsidiary.

To qualify to obtain control in or hold an interest in a financial subsidiary that engages in activities as principal or conduct any new activity pursuant to Section 46(a) of the Federal Deposit Insurance Act, the insured state nonmember bank must certify that it meets the following criteria:

1. The bank is well-managed, and
2. The bank and all of its insured depository institution affiliates are well-capitalized as defined by the appropriate capital regulation and guidance of each institution's primary federal regulator after deducting its investment in the subsidiary.

In addition, a state nonmember bank must also meet, and continue to meet, the following additional requirements:

1. Disclose the capital deduction in any published financial statements. The bank will deduct the aggregate amount of its outstanding equity investment, including retained earnings, in all financial subsidiaries than engage in activities as principal pursuant to Section 46(a), from the bank's total assets and tangible equity and deduct such investment from its total risk-based capital (this deduction should be made equally from Tier 1 and Tier 2 capital),

2. Not commence any new activity under Section 46(a) or directly or indirectly acquire control of a company engaged in any such activity if the bank or any of its insured depository institution affiliates received a rating of less than satisfactory in its most recent CRA examination,

3. Comply with 23A and 23B of the Bank Holding Company Act, and

4. Meet the financial and operational safeguards required by Section 5136A(d) of the Revised Statutes of the United States (12 U.S.C. 24a(d)) unless otherwise determined by the primary federal regulator.

As the definition pertains to state banks, a financial subsidiary is defined as any company that is controlled by one or more insured depository institutions other than: (1) a subsidiary that only engages in activities that the state bank is permitted to engage in directly and that are conducted on the same terms and conditions that govern the conduct of the activities by the state bank; or (2) a subsidiary that the state bank is specifically authorized to control by express terms of a federal statute (other than Section 46(a)).

*****Because Section 46(a) applies only to "as principal" activities, state nonmember banks may engage in agency activities without considering the requirements of this Section. Activities conducted other than "as principal" are generally defined as activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee, or in any substantially similar capacity.

Section 24 Activities

The addition of Section 46 does not eliminate Section 24, which permits state nonmember banks to apply to conduct certain activities that are permissible under State Laws and Regulations, but not approved for national banks. Congress, in reserving the FDIC's Section 24 authority over activities not covered by section 46, clearly intended to foster state innovation with respect to these reserved activities. These can continue to be considered on a case-by-case basis, through the required notification or application to the FDIC.

## NAME PERMISSION, RESERVATION, AND CHANGE

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The Department evaluates the use of the words "bank," "banker," "banking," "banking company," "trust", "trust company," or any variation thereof pursuant to O.C.G.A. § 7-1-243. Generally, before the Secretary of State allows an entity to incorporate or register a name containing such restricted word(s), the entity will be required to obtain written permission from the Department to use such word(s). Only name permission applications complying with the requirements of O.C.G.A. §§ 7-1-243 and 7-1-130 will be approved.

The Department evaluates name reservations and changes pursuant to O.C.G.A. § 7-1-131. The Department has exclusive jurisdiction over name reservations of corporate names for state financial institutions. The Department must conclude that the proposed name complies with O.C.G.A. § 7-1-130. Name reservations are valid for a period of six months.

### EVALUATION FACTORS

O.C.G.A. § 7-1-243 generally prohibits an entity engaging in lending money, underwriting or selling securities, acting as a financial planner, financial service provider, investment or trust adviser, or acting as a loan broker from using the words "bank," "trust," and/or any variation thereof in its name. An entity engaged/proposing to engage in such activities may not "embed" a restricted word in its name.

The Department considers the words "bank," "trust," and/or any variation thereof to be widely recognized as being used by or associated with financial institutions. Therefore, to avoid confusion among the general public, the Department strongly discourages the ambiguous use of such words. If an entity desires to use a restricted word in its name, the name must be distinct from financial institutions and clearly indicate the business activity/proposed business activity of the entity. Name permission requests must contain a statement explaining why the entity wants to use such restricted word(s) in its name.

O.C.G.A. § 7-1-130 prohibits the name of a financial institution from containing the words "Government," "Official," "Federal," "National," or "United States" or any abbreviation of such words. Additionally, the name of the financial institution must be distinguishable from the corporate name of another financial institution conducting a banking business in this state as reflected in the records of the Department and shall not contain any word which may lead to the conclusion that the financial institution is authorized to perform any act or conduct any business which it is unauthorized or forbidden to perform by law, its articles, or otherwise. The Department may approve a name for a bank holding company that is not distinguishable on the records of the Secretary of State from the name of a deposit taking financial institution wholly-owned by that bank holding company. If such bank holding company subsequently sells the bank with a similar name, the bank holding company may retain its name only if the subject bank's name is no longer in use.

When considering a name permission, reservation, or change request, the Department does not perform a trademark review. Such trademark review should be performed by the applicant's legal counsel. It should be noted that the usage of a name which is similar to the name of a financial institution could represent potential legal risk to the applicant.

### PROCESSING PROCEDURES

#### NAME PERMISSION APPLICATIONS

Entities seeking the Department's permission to use a name containing restricted words should file the online application located on the Department's website at: http://dbf.georgia.gov/webform/request-permission-use-bank-credit-union-trust-or-similar-words-name. Sufficient documentation supporting the name request should be included within the application.

#### NAME RESERVATION AND CHANGE APPLICATIONS

Entities seeking a name reservation or change should submit a letter form application. The application should state whether the request is for a new financial institution and include the intended county for the main office, or for a change in the name of an existing financial institution.

Name permissions, reservations, and changes will be acted upon within ten days of receipt of the application unless there are concerns about conformity with the statutory requirements. If approval is granted, a letter will be sent to the applicant. The Department will transmit a copy of the approval letter to the Secretary of State's Office for name reservations and name changes. Applicants receiving a name permission approval from the Department should follow the procedures outlined by the Secretary of State's Office for submission of the Department's approval letter.

## ADOPTION OF TRADE NAME

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The Department evaluates the use of trade names pursuant to O.C.G.A. § 7-1-130. Trade names must be registered with the appropriate Superior Court Clerk. O.C.G.A. § 10-1-490. The Federal bank regulatory agencies have developed the Interagency Statement on Branch Names which should be reviewed prior to adopting a trade name.

### EVALUATION FACTORS

O.C.G.A. § 7-1-130 prohibits the name of a financial institution from: a) containing certain words ("Government," "Official," "Federal," "National," or "United States"), b) being indistinguishable from the corporate name of another financial institution, or c) containing any word that would lead to the conclusion that the financial institution is authorized to conduct business which it is unauthorized to perform by law. Notwithstanding these limitations, a financial institution may use a name of another financial institution already transacting business with the consent of the latter institution, provided that the names are distinguishable in the records of the Secretary of State. The Department performs the trade name notification review for any Georgia financial institution and for a foreign corporation seeking to do business as a bank in Georgia in the same manner as it does corporate name permissions. Use of similar names could lead to customer confusion and potential liability on the part of the bank attempting to use the trade name. Additionally, financial institutions need to take reasonable steps to ensure that customers will not incorrectly assume that the trade name entity(ies) is a separate institution from the financial institution, or that deposits in different facilities are separately insured.

The Department requires that the legal, corporate name of the bank be disclosed on all legal documents, including but not limited to, certificates of deposit, signature cards, loan agreements, account statements, checks, drafts, and other similar documents. In the absence of such clear disclosure, the customer may already have deposits in the bank and could potentially exceed the applicable deposit insurance limitation unknowingly. Additionally, signs, advertising, and similar materials should also disclose, clearly and conspicuously, that the trade name entities are a unit of the legal, corporate name of the financial institution. Officers and employees should be trained in minimizing any possible customer confusion with respect to deposit insurance. Bank staff at an office, facility, or branch operating under a trade name should inquire of customers, prior to opening new accounts, whether they have deposits at the institution's other offices, facilities, and branches.

### PROCESSING PROCEDURES

Banks seeking use of a trade name should submit a letter form notification as detailed in the Applications Manual. The Department will review its records for name duplication in an effort to ascertain that it is distinguishable from any other financial institution name on the records of the Department. If the Department determines that the trade name does not meet the requirements of O.C.G.A. § 7-1-130, communication will be provided to the bank within ten days from receipt of the notification; otherwise the Department will acknowledge receipt of the notification within ten days. This acknowledgement will not constitute a guaranty that the applicant entity is free from any liability for use of the trade name. There are numerous cases interpreting use of trade names and the entity is encouraged to review this issue with legal counsel. This notification procedure is separate and distinct from the application procedure for permission, reservation, and change of corporate names.

# CHANGES IN CAPITAL STRUCTURE

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The Department has responsibility for the maintenance of a safe and sound banking system operated in the public interest. An integral part of this responsibility is the review of proposed capital changes by banks.

## DISCLOSURE

The Department requires that prospective investors be provided with all material facts to permit informed investment decisions in connection with all offerings. Offering circulars are desired for public offering of debt or equity securities by a bank.

It shall be the responsibility of the bank to disclose any material facts or circumstances bearing on the present condition of the bank or its future prospects where such facts or circumstances might reasonably be expected to influence a prospective purchaser's decision.

As indicated above, it would be necessary to disclose any material fact or circumstance regarding the present condition or the future prospects of the institution(s) involved. For further guidance in preparing such disclosure statements, general reference is made to the anti-fraud provisions of State and Federal securities statutes and more specific reference is made to a policy statement of the Federal Deposit Insurance Corporation entitled “Statement of Policy Regarding Use of Offering Circulars in Connection with Public Distribution of Bank Securities."

Where the Department has reason to believe that adequate disclosure will not be made or that particular disclosures beyond the ordinary are necessary, Departmental review of disclosure material may be required as a condition to approval of the issuance of the security.

## PRICING

Offerings of common stock should be at a fair price. When the stock is actively traded, the market value should be used as the primary indicator of a fair offering price. When the stock has a thin or controlled market, earnings and book value per share should be given greater consideration than market value in determining a fair offering price. In considering earnings and book value, a comparison to similar banks should be made. Material differences between book value and current value of assets and liabilities should be given appropriate recognition in making such comparisons.

In determining the conversion price in connection with issuance of convertible securities, consideration should be given to the current fair value of the common stock, the dividend or interest rate, current market conditions and the anticipated increase in fair value of the common stock during the conversion period.

## DEBT ISSUES

In evaluating a bank's capital capacity to issue debt, consideration will be given to recent earnings trends, retained earnings in light of anticipated dividend payments, impact of unusual income and expense items on recent earnings, recent acquisitions or mergers, prospective growth of the bank, quality of management, quality of assets, earnings, loan losses, sensitivity of interest income and expense to changes in market rates, degree of reliance on potentially volatile sources of funds, and the relative strength of earnings of nonbank affiliates or subsidiaries. The accessibility of additional equity capital also will be taken into account.

The total amount of subordinated notes and debentures outstanding including the debt proposed to be issued but excluding any debt to be retired out of the proceeds of the new issue may not exceed fifty percent of total statutory capital base at the time of issue of the new debt. However, banks with significant asset or management problems are not presumed to be entitled to issue debt capital up to the fifty percent ceiling.

An applicant bank proposing to issue subordinated debt should demonstrate that its recent income record is sufficient to provide assurance of that bank's ability to pay the additional fixed charges out of earnings.

No indenture or other contract covering the issuance of a subordinated note or debenture shall include any covenants, restrictions or other terms that are inconsistent with safe and sound banking practices.

## REDEMPTION AND CONVERTIBILITY OF SHARES AND DEBT SECURITIES

Preferred stock or debt securities may be redeemable for common stock using an equitable method subject to the approval of the Department and the vote of the shareholders and directors required to authorize an increase in capital stock.

## STOCK OPTION AND STOCK PURCHASE PLANS

Generally, plans qualified under the Internal Revenue Code will be approved. Nonqualified plans may be approved if the terms are fair and reasonable. Shares allocated to a plan should not exceed ten percent of total shares outstanding.

## OTHER

The method of disposal of fractional shares and unexercised preemptive rights should be fair. Fees and expenses paid to underwriters and others should be reasonable.

## PROCEDURES

Banks desiring to effect changes in capitalization should obtain forms and instructions from the Department. Applications for capital changes should be filed with the Department.

# BANK HOLDING COMPANY FORMATIONS AND ACQUISITIONS

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It is the policy of the Department to preserve the soundness of the banking system and promote market structures conducive to competition. A proposed formation of a bank holding company or acquisition of additional banking subsidiaries by a bank holding company (all hereinafter referred to as acquisitions) which would have a substantially adverse effect on existing or potential competition cannot be approved unless public convenience and needs clearly outweigh the anticompetitive effects of the proposed acquisition. An acquisition which would result in a monopoly of the business of banking in any part of this state will not be approved under any circumstances. An acquisition which would not have a substantially adverse effect on competition and which would be beneficial to the applicant and to the public normally would be approved provided that other banking factors are found to be favorable.

In evaluating an application for acquisition the following factors will be considered:

- The effect of the transaction upon competition;
- The convenience and needs of the community to be served;
- The financial history of the applicant holding company as well as the bank to be acquired;
- The condition of the applicant holding company and the bank to be acquired including capital, management, and earnings prospects;
- The existence of insider transactions;
- The adequacy of disclosure of the terms of the acquisition; and
- The equitable treatment of minority shareholders of a bank to be acquired.

In order to determine the effect of the proposed acquisition upon competition, it is necessary to identify the relevant geographic market. The delineation of such market can seldom be precise, but realistic limits should be established so the effect of the acquisition on competition can be properly analyzed. The market should be delineated to encompass an area where the effect on competition will be direct and immediate. The Department recognizes that different banking services may have different relevant geographic markets. Although the largest borrowers and depositors may find it convenient and practical to conduct part of their banking business outside the relevant geographic market, the market should not be drawn so expansively as to cause the competitive effect of the acquisition to seem insignificant because only the largest customers are considered. Conversely, the market should not be drawn so narrowly as to place competitors in different markets because only the smallest customers are considered. A fair delineation of the relevant geographic market should take into account the demands of most customers for the bank's services.

After the relevant geographic market has been identified, the competitive effects of the proposed acquisition can be analyzed. Both the structure of the market and the intensity of competition within the market place will be considered. In measuring intensity of competition consideration will be given to the number of competitors in the market, services offered, pricing of services, advertising, office hours and banking innovations.

## COMPETITIVE EFFECTS

The following terms will be used to describe the competitive effects of a proposed acquisition:

NO ADVERSE EFFECT. This term will be used when no change in competitive conditions would result from the acquisition. Acquisitions involving corporate reorganizations where the number of alternative sources of banking services are unchanged and where no resulting substantive change in ownership occurs are included in the category.

NOT SUBSTANTIALLY ADVERSE. This term will be used when some anticompetitive effects are present but such effects are not deemed sufficiently substantive to cause an undesirable competitive condition.

SUBSTANTIALLY ADVERSE. This term will be used when an anticompetitive condition would result from an acquisition. An acquisition involving a dominant bank in a market and any other bank in the same category could be included in this category.

When substantially adverse effects exist, they must be clearly outweighed in the public interest by the probable effects of the acquisition on improved convenience and needs. If not clearly outweighed, the acquisition will be disapproved. Convenience and needs factors which may outweigh the anticompetitive effects of an acquisition include:

1. The elimination of a failing, weak or stagnating bank, thereby strengthening the banking system;

2. The achievement of economies of scale including a better matching of source and needs of funds, thereby providing the basis for improved customer service and bank earnings; and

3. The extension of services not available from the bank being acquired and for which there is a clearly definable need. Such services might include a larger lending limit, specialized forms of credit, data processing, international banking, financial counseling or fiduciary services.

The Department must consider the convenience and needs of the community to be served in every acquisition, regardless of competitive effects. An acquisition not having a substantially adverse competitive effect may be disapproved if there are adverse effects on convenience and needs.

In addition to the foregoing, the Department considers banking factors and will normally not approve the acquisition if the acquiring company or the bank being acquired have inadequate capital, unsatisfactory management or poor earnings prospects. Further, it is required that all shareholders be adequately informed of all aspects of the transaction.

If the title of the bank being acquired is not to remain the same, the proposed new title will be considered in accordance with the Policy Statement for Title Changes.

When considering the acquisition of a bank which was organized under the sponsorship of the acquirer or an affiliate of the acquirer, there shall be a presumption of prior control and the acquisition shall normally not be permitted:

1. Where the aggregate of shares of the bank purchased during the bank's original capitalization and owned by the acquirer, owned by stockholders of the acquirer, or pledged as collateral against loans made by the acquirer exceeds 40% of the outstanding shares of the bank; or

2. Where management or consulting agreements have been instituted which allow the acquirer or its officials to exercise a controlling influence over the bank.

## DISCLOSURE

When an existing bank holding company or a proposed bank holding company submits an application to this office for permission to acquire a bank or a bank holding company, it is the policy of the Department to encourage such existing or proposed bank holding company to make an equitable, but not necessarily the same, offering to 100% of the shareholders of the bank to be acquired. However, it shall not be the policy of the Department to require absolutely that such an offering be made as a condition for the approval of such an application.

It shall be the policy of the Department to require that adequate written disclosures be made to those shareholders of a bank or a bank holding company who are to receive purchase and/or exchange offers from an existing or a proposed bank holding company or individuals connected with such organizations. In making such disclosures, it shall be the responsibility of the purchasing bank holding company to disclose any material fact or circumstance bearing on the present condition of the bank and/or the existing or proposed bank holding company or any material fact or circumstance regarding the future prospects of either or both organizations, where such facts might reasonably be expected to influence an offer. This policy shall not be applicable to offerings which are the subject of a registration under Federal Securities Laws and Regulations or offerings which are made only to persons serving as Directors and/or policy making officers of the institution being acquired or to the immediate families of such persons. Immediate family members shall include only those members residing in a common household.

As indicated above, it would be necessary to disclose any material fact or circumstance regarding the present condition or the future prospects of the institution(s) involved. For further guidance in preparing such disclosure statements general reference is made to the anti-fraud provisions of State and Federal securities statutes and more specific reference is made to a policy statement of the Federal Deposit Insurance Corporation entitled Statement of Policy Regarding Use of Offering Circulars in Connection with Public Distribution of Bank Securities."

Disclosures in regard to the effect of the proposed acquisition on the future dividend policy of the institution to be acquired and/or the acquiring institution are considered to be of primary importance by the Department. At a minimum, the Department feels that disclosures, in regard to the future dividend policy of the institution to be acquired, should provide an indication as to whether a shareholder who chooses not to sell (or exchange) his shares to the acquiring bank holding company could reasonably expect a sizeable increase in dividends after the consummation of the proposed transaction. In that regard, the Department would prefer that the projections, especially those regarding dividends, submitted with the application be made a part of the disclosure statement; but, at a minimum, the Department feels that the disclosure statement should contain a statement to the effect that these projections are on file with the Department and include the Department's current address.

As a precautionary note, prospective applicants should avoid stock acquisitions "in anticipation or with knowledge of" a holding company formation unless complete and adequate disclosure is made in conjunction with any offers to purchase shares. The Department may require remedial action by means of offers to rescind the transactions or otherwise where proper disclosure has not been made.

## COMPENSATION AGREEMENTS

Compensation agreements in favor of active management officials of a bank being acquired by a bank holding company which provide for compensation for such officials at levels comparable to current compensation from the targeted bank or to compensation of officials holding positions of comparable responsibility with other banking subsidiaries of the bank holding company involved, whichever is greater, shall be considered as obligations either of the bank being acquired or a successor bank if the acquisition is through merger with another bank; provided, the management official continues in the active employment of the bank throughout the terms of the agreement in a position of substantially similar responsibility. Provided further, however, that such agreements may provide for reasonable retirement benefits for such management officials at such time as such official would qualify for normal retirement under conditions existing at either the bank being acquired or at the bank holding company or its other banking subsidiaries at the time of acquisition.

All other compensation agreements which do not qualify for treatment set forth above shall be deemed to be part of the cost of acquisition of the bank being acquired and shall be accorded appropriate treatment as such under generally accepted accounting principles. Such other agreements shall be deemed obligations of the holding company; provided, however, they may be accorded treatment as obligations of any banking subsidiary of the holding company into which the bank being acquired has been merged where such subsidiary operated as a financial institution prior to the acquisition and was not organized for the purpose of facilitating the acquisition.

## CORPORATE RESTRUCTURING

Effective October 15, 1995, the Department adopted a regulation, which under certain conditions and with the permission of the Commissioner, would allow a corporate restructure within a holding company. This regulation interprets current law to allow holding companies broad flexibility to internally reorganize their corporate structure provided the restructuring in no way constitutes an acquisition of control. For example, the regulation would allow a holding company to move a branch belonging to one subsidiary bank to another, more appropriate, subsidiary bank within the company for internal business or market reasons.

## PROCEDURES

Parent companies desiring to acquire a bank should obtain forms and instructions from the Department. Reference should be made to the Department's Applications Manual for filing requirements. The Department may conduct an examination into the condition of the parties to the application to the extent deemed necessary. The cost of such examination shall be included in the application filing fee.

**NOTE**: A state bank must follow procedures and meet the criteria of the Federal Reserve Bank to become a financial holding company. No state application is necessary.

# CHANGE IN CONTROL

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The Department is required to approve the acquisition of control of any financial institution, including bank holding companies, prior to the consummation of that acquisition. The only major exceptions to this requirement are acquisitions approved pursuant to the bank holding company procedures. The Department must be given at least 60 days prior written notice of any proposed acquisition and has the same 60-day period within which to disapprove the transaction. An acquisition may be made prior to expiration of the disapproval period if the Department issues a written notice of its intent not to disapprove the transaction. "Control" is defined as the power to direct the management or policies of the financial institution, either directly or indirectly, or to vote 25% or more of any class of the voting securities of a financial institution. A "person" means an individual, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, or unincorporated organization.

## FACTORS TO BE CONSIDERED

The Department may disapprove a proposed acquisition under any of the following conditions:

1. If the proposed acquisition would result in a monopoly or would attempt to monopolize the business of banking in any part of the State.

2. If the proposed acquisition would lessen competition or tend to create a monopoly to any section of the State or would in any other manner be restraint of trade not outweighed by meeting the convenience and needs of the community to be served.

3. If the financial condition of any acquiring person might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank.

4. If the competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the best interest of the depositors of the bank or in the interest of the public to permit the acquisition.

5. If any acquiring person does not furnish the Department all of the required information in connection with the application.

Any person or persons making application for change in control must provide information relating to personal history and business background for a period of at least the past five years with a description of any material legal proceedings in which the party is involved, financial information prepared in accordance with generally accepted accounting principles, complete terms and conditions of the proposed acquisition, including the source of funds, and complete details of any borrowings made in connection with the acquisition by any of the parties involved. Also, the application must detail any plans or proposals which the acquiring party may have to liquidate the bank or sell its assets or to merge it with any company or, to change in any other way its business or corporate structure or its management. If any person or firm has been employed to make solicitations or recommendations to stockholders for the purpose of assisting in the acquisition, a description of the terms of this arrangement along with all copies of any invitations, tenders or advertisements for a tender offer to stockholders must be submitted in conjunction with the application. The Department may also make a specific request in connection with a particular notice for additional information.

## PROCEDURES

The Department, in recognition of similar approval requirements by Federal bank regulatory agencies, will initially accept a copy of an application for change in control completed on forms utilized by the appropriate Federal bank regulatory agency. Such forms and instructions may be obtained from the Department. Any additional information needed will be specifically requested. In facilitating any acquisitions which are contingent upon financing, the Department requires a firm letter of commitment from a lender outlining the general terms of the borrowing transaction and the amount of liability to be extended. Following consummation of any change of control, a summary report of the transaction must be filed on forms available through the Department.

# CAPITAL ADEQUACY FOR FINANCIAL INSTITUTIONS

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## BANKS

The Department has long recognized the need for addressing capital adequacy and the definition of capital with the goal of establishing known criteria and standard definitions among all regulatory agencies to guide banks in developing their capital formulation plans and requirements. The Department has had a policy in effect for many years, but changes are now being made in an effort to eliminate differences in the definitions of capital, assets, and related terms between the Department and Federal agencies. Now that a standard definition of capital is utilized by all Federal regulatory agencies, the Department believes that its definitions should also be the same for the sake of clarity and uniformity. This revised policy is not intended to significantly change the required levels of capital from those that were required under the previous policy.

The capital standards established in this policy do not represent a significant change from the previous policy capital standards regarding the required levels of capital. The definition of capital has been changed from the Department's previous "Primary Capital" definition which included the Allowance for Loan and Lease Losses to the "Tier 1 Capital" definition used by all the Federal regulatory agencies. The change in the capital definition required some adjustment of the minimum acceptable ratios to counter the effects of no longer including the Allowance for Loan and Lease Losses in the determination of capital adequacy. The net effect of this change on Georgia state-chartered institutions is believed to be negligible. This new policy is being adopted in an effort to eliminate the unnecessary confusion and regulatory burden that results from using different definitions of capital and methods of ratio calculation by the Department and the Federal Regulatory Agencies.

### CAPITAL DEFINED

The definition of Tier 1 Capital contained in Part 325 of the Federal Deposit Insurance Corporation Rules and Regulations is the definition of capital for purposes of this policy on capital adequacy. All terms defined in Part 325 that affect the determination of the amount of Tier 1 Capital apply. Generally, Tier 1 Capital means the sum of common stockholders' equity (common stock, paid-in surplus, appropriated retained earnings, capital reserves, retained earnings, undivided profits, and other capital segregations), noncumulative perpetual preferred stock (including any related surplus), and minority interests in any consolidated subsidiaries, minus all intangible assets except mortgage servicing rights and purchased credit card relationships, minus identified losses.

### TOTAL ASSETS DEFINED

The definition of Total Assets contained in Part 325 of the Federal Deposit Insurance Corporation Rules and Regulations is the definition of Total Assets for purposes of this policy on capital adequacy. All terms defined in Part 325 that affect the determination of the amount of Total Assets apply. Generally, Total Assets means the average of total assets required to be included in the Bank's "Reports of Condition and Income" (Call Report) as of the most recent report date, minus intangible assets other than mortgage servicing rights and purchased credit card relationships, minus identified losses.

### CAPITAL ADEQUACY

Prior to assessing the adequacy of capital, all adjustments necessary to bring the Bank's capital into compliance with the definition of Tier 1 Capital will be made. The following adjustments to capital accounts must be made.

1. An adequate Allowance for Loan and Lease Losses will be established. Adequacy will be determined based on the condition of the loan and lease portfolios and must be determined in accordance with an acceptable methodology that is comprehensive, adequately documented and consistently applied. The Allowance for Loan and Lease Losses should be no less than the sum of the following:

   - All loans classified Loss,
   - For loans and leases classified Substandard or Doubtful, whether analyzed and provided for individually or as part of pools, all estimated credit losses over the remaining effective lives of these loans.
   - For loans and leases that are not classified, all estimated credit losses over the upcoming 12 months.

   Management's analysis of an adequate reserve level should be conservative to reflect a margin for the lack of precision inherent in estimates of expected credit losses.

2. All other adjustments to asset, liability, and capital accounts will be made to assure that the Bank's books are maintained in accordance with Generally Accepted Accounting Principles.

After all necessary adjustments are made to determine the amount of Tier 1 Capital and Total Assets, the minimum level of Tier 1 Capital will be an amount sufficient to yield a Tier 1 Capital to Total Assets Ratio of 4.5%. Provided, however, that Banks having less than $3,000,000 of Tier 1 Capital will maintain a ratio of at least 5.5%, unless Tier 1 Capital is less than $2,000,000, in which case the ratio will be at least 6.5%. Any Banks having Tier 1 Capital below these minimum levels will be required to immediately provide for injection of additional equity capital.

The foregoing minimum capital levels may be less than desirable even for institutions determined to be financially sound, well, managed, and diversified with established records of adequate capital formation relative to asset growth. Higher levels of capital may be required based upon a qualitative evaluation of those critical variables that directly bear on the institution's overall financial condition. The Department reserves the right to require higher levels of capitalization based upon such qualitative analysis of the circumstances under which the institution is operating or is forecast to operate. Such requirements would be subject to review upon the request of the bank. In considering a determination for higher levels of capital, the Department will consider such factors as quality, type, and diversification of assets; current and historical earnings; provisions for liquidity with particular emphasis on asset/liability mismatches and sensitivity to market risks in the asset portfolios; the quality of management; and the existence of other activities that may expose the institution to risk, including the degree of leverage and risk undertaken by any parent company or affiliates. Plans for restoring deficiencies in the level of capital will be reviewed in light of such factors as marketing constraints on new stock, required disclosures or proxy material effects and preparation time, pending matters of fact, and financial strengths and weaknesses of and written commitments from affiliated corporations as well as any other factors which are clearly not of a speculative nature and which might materially affect the capital accounts of the institution.

Banks found to have a Tier 1 Capital ratio which is less than acceptable as determined by appropriate analysis or which is less than 5.5% will be required to adopt a policy of capital planning and formulation to address the institution's forecasted capital needs for the following twenty-four months, and such policy will be reviewed semiannually by the Board of Directors. For banks found to have capital below the minimum levels of 4.5%, 5.5%, and 6.5% for total capital levels $3,000,000 or more, $3,000,000 to $2,000,000, and less than $2,000,000, respectively, the Department will require specific capital infusion proposals to respond in an appropriately prompt manner to the needs of the institution.

It is anticipated that most institutions will require a Tier 1 Capital ratio of 5.5% or more as determined by routine examination and evaluation. This policy is designed to provide sufficient flexibility to allow the Department, Federal authorities, and the Board of Directors of each bank to address adequately the unique financial needs and market conditions in which each institution operates while at the same time to establish certain minimum standards which must be met by all institutions regardless of size or corporate structure and affiliation. The policy provides some guidance regarding the evaluation process and criteria and the remedial steps that may be faced when deficiencies exist.

With respect to the three-tiered minimum capital provisions, further comments are appropriate. The current Department policy with respect to new charters for banks is to require a minimum initial capitalization of $3,000,000 with larger amounts required when warranted in light of economic and market conditions. This is in conformity with statutory minimum capital requirements, although in practice, the Department has required higher levels of initial capitalization. There are certain risks associated with engaging in the banking business which are not entirely variable according to institution size or complexity. This minimum risk must be covered by some minimum level of capital, or $3,000,000. The Department also recognizes, however, that it is not practical to expect those long-established but smaller institutions which have less than the desired minimum level of $3,000,000 to bring themselves up to this level immediately and that normal growth will eventually accomplish this goal. In lieu of maintaining the minimum dollar level of capital, these smaller institutions are allowed to partially offset the deficiency through maintenance of a slightly higher Tier 1 Capital ratio.

Relaxation of the capital standards historically followed by the Department will require transition to protect "freed" capital from unnecessary or unwarranted dissipation. Extraordinary dividends proposed in recognition of the changes in capital adequacy standards utilized by the Department which would be in excess of amounts which could be paid without departmental approval will be considered for approval where prudent. Consideration will be based upon the purpose of the dividends and their financial impact. Dividends will normally be approved where the amounts to be paid are directed to debt service retirement for a parent company. Original holding company approvals involving debt service by a subsidiary bank were granted after consideration of the ability of the subsidiary financial institutions to provide the required level of debt service through future earnings and capital formation policies put forth by the applicant at the time of approval. Accordingly, it would not be appropriate to divert those capital resources to some other purpose without thorough study of the future effects of such actions. Added growth and orderly changes in dividend policy within the limitations of existing or proposed regulations should be adequate methods of accomplishing any capital attrition which the Board of Directors determines to be appropriate and in keeping with sound banking practices in light of the change in Departmental capital adequacy standards.

## HOLDING COMPANIES

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The following capital guidelines are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Department. The Department will review the guidelines from time to time for possible adjustment commensurate with changes in the economy, financial markets, and banking practices.

### CAPITAL DEFINED

The definition of Tier 1 Capital (core capital) contained in the Appendix A to Regulation Y issued by the Board of Governors of the Federal Reserve System is the definition of capital for purposes of this policy on capital adequacy for bank holding companies. All terms defined in Appendix A to Regulation Y that affect the determination of the amount of Tier 1 Capital apply. Generally, Tier 1 Capital means the sum of common stockholders' equity (common stock, paid-in surplus, appropriated retained earnings, capital reserves, retained earnings, undivided profits and other capital segregations), minority interests in any consolidated subsidiaries, noncumulative perpetual preferred stock and cumulative perpetual preferred stock that does not exceed 25% of total Tier 1 Capital, minus mortgage servicing rights and purchased credit card relationships that together exceed 50% of total Tier 1 Capital, minus purchased credit card relationships that exceed 25% of total Tier 1 Capital, minus goodwill and all other intangible assets, minus any investments in subsidiaries or associated companies that either the Federal Reserve or the Department has excluded from inclusion in Tier 1 Capital.

### TOTAL ASSETS DEFINED

Average Total Consolidated Assets as defined in Appendix D to Regulation Y issued by the Board of Governors of the Federal Reserve System is the definition of Total Assets for purposes of this policy on capital adequacy for holding companies. All terms defined in Appendix A and D to Regulation Y that affect the determination of Average Total Consolidated Assets apply. Generally, Total Assets means the quarterly average total consolidated assets (net of the allowance for loan and lease losses) required to be reported on the holding company's Consolidated Financial Statements (FR Y-9C Report) as of the most recent report date, minus mortgage serving rights and purchased credit card relationships that together exceed 50% of Tier 1 Capital, minus purchased credit card relationships that exceed 25% of Tier 1 Capital, minus goodwill and all other intangible assets, minus any investments in subsidiaries or associated companies that either the Federal Reserve or the Department has excluded from inclusion in Tier 1 Capital.

### CAPITAL ADEQUACY

Prior to assessing the adequacy of capital, all adjustments necessary to bring the holding company's capital into compliance with the definition of Tier 1 Capital will be made. The following adjustments to capital accounts must be made.

1. An adequate Allowance for Loan and Lease Losses will be established. Adequacy will be determined based on the condition of the loan and lease portfolios and must be determined in accordance with an acceptable methodology that is comprehensive, adequately documented and consistently applied. The Allowance for Loan and Lease Losses should be no less than the sum of the following:

   - All loans classified Loss,
   - For loans and leases classified Substandard or Doubtful, whether analyzed and provided for individually or as part of pools, all estimated credit losses over the remaining effective lives of these loans.
   - For loans and leases that are not classified, all estimated credit losses over the upcoming 12 months.

   Management's analysis of an adequate reserve level should be conservative to reflect a margin for the lack of precision inherent in estimates of expected credit losses.

2. All other adjustments to asset, liability and equity accounts shall be made to assure that the holding company's books are maintained in accordance with Generally Accepted Accounting Principles.

After all necessary adjustments are made to determine the amount of Tier 1 Capital and Total Assets, the minimum level of Tier 1 Capital shall be an amount sufficient to yield a Tier 1 Capital to Total Assets Ratio of 4.0%. Provided however that holding companies having less than $150 million in Total Consolidated Assets, no significant debt held by the general public, no nonbank activity involving significant leverage, and no significant off-balance sheet activities, will generally not be covered by this minimum consolidated capital ratio. Minimum capital ratios for these smaller and less complex institutions will generally be applied on a subsidiary only basis. Any covered holding company having Tier 1 Capital below the minimum ratio level shall be required to provide for injection of additional equity capital, as outlined in the Supervisory Action Section that follows.

Some holding companies engage in significant nonbanking activities that typically require capital ratios higher than those of financial institutions alone. The Department believes that as a matter of both safety and soundness and competitive equity, the degree of leverage common in banking should not automatically extend to nonbanking activities. Consequently, in evaluating the consolidated capital position of such organizations, emphasis is placed upon the levels of capital for subsidiaries which are not engaged in the business of banking consistent with the levels that have been established by industry norms or standards for similar firms that are not affiliated with the organization, or that may be established by the Department after taking into account the risk factors of a particular industry. The assessment of an organization's consolidated capital adequacy must take into account the nature and level of all nonbanking activities and an organization's consolidated capital position should at least equal the sum of the capital requirements of the organization's banking and nonbanking subsidiaries as well as those of the parent company.

The minimum ratio of Tier 1 capital to total assets will be reduced to 3.0% for bank holding companies that are rated a composite “1" under the BOPEC rating system and for bank holding companies that have implemented the risk-based capital market risk measures set forth in 12 CFR 225, Appendix E, of the Federal Reserve Board. Note that the latter requirement is generally applicable to bank holding companies with trading activity equivalent to 10% or more of total assets or $1 Billion or more.

Higher capital ratios would be required for bank holding companies with significant financial and/or operational weaknesses, higher risk profiles or companies experiencing or anticipating rapid growth.

<u>SUPERVISORY ACTION</u>

The nature and severity of supervisory action will be determined by an organization’s compliance with the required minimum Tier 1 Capital Ratio. Holding companies with capital ratios below the minimum will be considered under capitalized unless they can demonstrate clear extenuating circumstances. Such under capitalized organizations will be required to submit an acceptable plan for achieving compliance with the capital guidelines and will be subject to denial of applications and appropriate supervisory enforcement actions.

Where the capital ratio does not meet the minimum policy requirements, the Department will normally initiate the following types of action, subject to qualitative analysis:

- Require the institution to submit a comprehensive capital plan, acceptable to the Department that includes a program for achieving compliance with the required minimum ratio within a reasonable period of time.

- Pay particular attention to financial factors, such as asset quality, liquidity, interest rate risk and off-balance sheet risk as they relate to capital. If these areas are deficient and capital is not considered adequate, the Department will intensify its monitoring efforts and take appropriate supervisory action.

- Institute appropriate supervisory and/or administrative enforcement actions, which may include the issuance of a capital directive or denial of applications, unless a capital plan acceptable to the Department has been adopted by the institution.

<u>INTANGIBLE ASSETS</u>

Intangible Assets except those specifically included and in amounts established by definition as Tier 1 Capital, will not be considered in determining compliance with the minimum capital ratio requirements of this policy.

<u>CAPITAL INSTRUMENTS NOT INCLUDED IN TIER 1 CAPITAL</u>

Capital instruments that, by definition of Tier 1 Capital, are either excluded from or exceed the limits allowed to be included in Tier 1 Capital will not be considered in determining compliance with the minimum capital ratio requirements of this policy. Such instruments may, however, contribute to the overall funding strategy of the holding company. Although not considered Tier 1 Capital, such capital instruments may be considered in a capital plan submitted by the holding company whereby the holding company will use such funding instruments for specific corporate purposes other than meeting the minimum Tier 1 Capital requirement of this policy. Such instruments may also be considered in a comprehensive capital plan utilizing them as an interim measure in correcting an overall under capitalized condition if the capital plan provides a reasonable assurance that the under capitalized condition will be remedied within a reasonable period of time through an increase in the Tier 1 Capital Ratio and the organization otherwise meets the minimum capital standards imposed by the Board of Governors of the Federal Reserve System and all applicable bank capital standards imposed by the applicable Federal Regulator and the Department for bank subsidiaries.

When such non Tier 1 Capital instruments are part of a holding company's capital plan as an interim means of funding until achievement of Tier 1 Capital adequacy, the Department will consider such instruments on a case by case basis. Generally, such instruments will be judged based on criteria contained in Appendix A to Regulation Y issued by the Board of Governors of the Federal Reserve System. The Department reserves the right to specifically disallow instruments as a part of a capital plan if, in the Department's judgment, such instruments will not contribute to the achievement of Tier 1 Capital adequacy within a reasonable period of time.

ASSESSMENT OF FINANCIAL FACTORS RELATING TO FORMATION OF UNITARY HOLDING COMPANIES

In acting on applications the Department has adopted, and continues to follow, the principle that holding companies should serve as a source of strength for their subsidiary banks and/or thrifts. When holding companies incur debt and rely upon the earnings of their subsidiary banks and/or thrifts as the means of repaying such debt, a question arises as the probable effect upon the financial condition of the subsidiary bank(s) or thrift(s). The Department believes that a high level of debt at the parent holding company level impairs the ability of a holding company to provide financial assistance to its subsidiary bank or thrift, and in some cases the servicing requirements of such debt may be a drain on the bank's or thrift's resources. For these reasons, the Department has not favored the use of acquisition debt in the formation of holding companies. Nevertheless, the Department has recognized that the transfer of ownership of small banks and thrifts sometimes requires the use of acquisition debt. Therefore, the Department has permitted the formation of small unitary holding companies with debt levels higher than would be permitted for larger or diversified holding companies. Approval of these applications has been given on the condition that the small unitary holding companies demonstrate the ability to service the acquisition debt without straining the capital of their subsidiary banks or thrifts and, further, that such companies restore their ability to serve as a source of strength for the subsidiary institutions within a relatively short period of time.

In considering applications for the formation of small unitary holding companies to facilitate the transfer of ownership of small banks and thrifts, the Department's analysis will focus on the relationship between debt and equity at the parent holding company level. The holding company will be expected to improve the relationship of debt to equity by repaying the principal amount of its debt or through the retention of earnings or both. Under these procedures, newly organized small unitary holding companies will be expected to reduce the ratio of debt to equity over a reasonable period of time to a level comparable to that maintained by many large and/or diversified holding companies.

Generally these assessment guidelines are intended to apply only to unitary holding companies having less than $150 million in Total Consolidated Assets, with no significant debt held by the general public, no non-bank activity involving significant leverage, and no significant off-balance sheet activities at the time the application is filed.

In evaluating applications in which the applicant intends to incur debt to finance the acquisition of a small bank or thrift, the Department will take into account a full range of financial and other information, including the recent trend and stability of earnings of the bank or thrift, the past and prospective growth of the bank or thrift, the quality of the assets of the bank or thrift, the ability of the applicant to meet debt servicing requirements without placing an undue strain on the resources of the bank or thrift and the record and competence of the management of the applicant and that of the bank or thrift. In addition the Department will require applicants to meet the minimum requirements set forth below. As a general rule, failure to meet any of these requirements will result in denial of the application; however, the Department reserves the right to make exceptions if the circumstances warrant.

MINIMUM DOWN PAYMENT

The amount of acquisition debt should not exceed 75 percent of the purchase price of the bank or thrift to be acquired. When the owner(s) of the holding company incur debt to finance the purchase of a bank or thrift, such debt will be considered acquisition debt even though it does not represent an obligation of the holding company, unless the owner(s) can demonstrate that such debt can be serviced without reliance on the resources of the bank, the thrift or the holding company.

MAINTENANCE OF ADEQUATE CAPITAL AT SUBSIDIARIES

An applicant proposing to use acquisition debt must demonstrate to the satisfaction of the Department that any debt servicing requirements to which the holding company may be subject would not cause the Tier 1 Capital to Total Assets ratio of the subsidiary bank of thrift to fall below 6.5% during the 12-year period following consummation of the acquisition.

REDUCTION IN PARENT COMPANY LEVERAGE

The applicant must demonstrate to the satisfaction of the Department that the parent holding company's ratio of debt to equity will decline to 30 percent within 12 years from the consummation of the acquisition. It must also be demonstrated that the holding company will be able to safely meet the debt servicing and other requirements imposed by its creditors.

The term "debt" as used in the ratio of debt to equity means any borrowed funds (exclusive of short-term borrowings that arise out of current transactions, the proceeds of which are used for current transactions), any securities issued by, or any other obligations of the holding company if such obligations of the holding company if such obligations are the functional equivalent of borrowed funds.

The term "equity" as used in the ratio of debt to equity means Tier 1 Capital as defined in this policy. In determining the amount of assets, liabilities and equity, the provisions of Generally Accepted Accounting Principles will apply.

DIVIDEND RESTRICTIONS

The holding company is not expected to pay any corporate dividends on common stock until such time as its debt to equity ratio is below 30 percent. However, some dividends may be permitted provided all the following conditions are met:

1. The applicant has begun making scheduled payments of principal on the acquisition debt.

2. Such scheduled payments of principal are reasonable in amount, will be made at least annually, and will provide for the retirement of the acquisition debt over a period not to exceed 25 years; and

3. The applicant can clearly demonstrate at the time the application is filed that such dividends will not jeopardize the ability of the holding company to reduce its debt to equity ratio to 30 percent within 12 years of the consummation of the acquisition or cause the Tier 1 Capital to Total Assets ratio of the subsidiary bank or thrift to fall below 6.5% over the same period.

Also it is expected that dividends will be eliminated if the holding company is not meeting the projections made at the time the application was filed regarding the ability of the holding company to reduce the debt to equity ratio to 30 percent within 12 years of the consummation of the proposal.

TRANSITIONAL PROVISIONS

Notwithstanding the foregoing, the Department may consider approval of the formation of a unitary holding company for financial institutions which do not meet applicable capital guidelines where the holding company formation will facilitate the restoration of adequate capital in the bank or thrift subsidiary. Such approvals will be under conditions which will not allow expansion of the financial institution or the acquisition of additional institutions by the holding company until the minimum capital established by this policy is achieved.

# INCIDENTAL BANKING POWERS

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As provided for in Rule Chapter 80-5-5 of the Department of Banking and Finance, the Commissioner may, by a letter opinion, grant to an institution a power which does not already have a specified application process, so long as the exercise of such power is consistent with the objectives of Chapter 1 of Title 7, provided the activity is deemed by the Commissioner to be financial in nature or incidental to the business of banking, and provided the nature of the activity does not pose significant risks to the financial institution. The Commissioner at his or her discretion may seek public comment before he or she approves such an incidental power, if the Commissioner determines that an appropriate public purpose would be served. If such a determination is made, a 30-day notice and request for comment shall be published in the Department's regular Monthly Bulletin and to such other parties, as the Commissioner deems necessary. The Commissioner shall take any comments received into account in making the final decision.

<u>PROCEDURES</u>

All requests for incidental banking powers shall be in letter form and shall contain, at a minimum, the following information:

1. A complete description of the power or activity that is being requested by the applicant;
2. An explanation by the applicant of why they believe the requested activity is incidental or complementary to banking;
3. An analysis of the proposed business structure of this activity, whether it is to be a bank subsidiary or division or some alternative structure;
4. The projected financial and operating impact of this activity upon the overall operations of the bank; and,
5. The proposed management structure for the activity.

All requests for incidental powers shall be reviewed by the assigned Supervisory Manager for a determination as to whether the proposed power is incidental to banking. The recommendation made by the Supervisory Manager will be forwarded to the Deputy Commissioner for Supervision.

The following action steps should be taken in determining whether a proposed power is incidental to banking:

1. A review of permissible activities for bank holding companies should be performed to determine whether the proposed activity is permissible for bank holding companies;
2. A review should be performed to determine whether the activity is permissible for national banks;
3. The FDIC should be contacted to determine what their position would be on the proposed activity and whether it would require specific FDIC approval;
4. CSBS should be contacted to determine whether the proposed activity has been approved and/or is being conducted in other states, and if so, which states;
5. It may be advisable to contact one or more of the regulators of these states to determine what their experience has been with the proposed activity;
6. An analysis of the projected financial and operating impact of the activity should be conducted to determine if there are any safety and soundness concerns;
7. It should be determined that there are no supervisory impediments or outstanding administrative actions that would impact the ability of the bank to take on these activities;
8. The proposed management structure should be reviewed to determine that a proper management structure would be in place to properly conduct the activity; and,
9. It should be determined whether the activity or management conducting the proposed activity would be subject to any special licensing, registration or regulatory requirements.

After this analysis has been performed and a recommendation is made to the Deputy Commissioner for Supervision, he or she will review the recommendation and forward it to the Commissioner for a final decision. In the event the Commissioner sustains a positive recommendation to consider the activity incidental to banking, this decision shall be included in the Monthly Bulletin of the Department, with an invitation for comments. The Commissioner shall review any comments received during this process and determine whether these comments should impact his or her recommendation regarding the proposed activity. In the event that the activity is approved, this information will be disclosed in the subsequent Monthly Bulletin of the Department.

## LEASING OF BANK PREMISES TO NON-AFFILIATED ENTERPRISES FOR THE PURPOSE OF PROVIDING GOODS OR SERVICES TO BANK CUSTOMERS

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From time to time, the Department has reviewed specific proposals under which banks are being asked to contract with non-affiliated companies for the company to lease space within the bank's premises and to market its services or products to bank customers and others. The services most frequently offered are insurance, securities, or mortgages. Where permitted under Georgia law, the leases may be structured with a floating rental based upon gross revenues from the activity. Insurance may be sold directly by a bank or through a third party so long as the bank is a licensed insurance agency. The Department believes offering these services to supplement bank income and to expand the services available to bank customers is a legitimate alternative for banks where direct offering of the services is restricted by law or where the bank feels that its financial and managerial resources can best be used elsewhere.

Banks considering this alternative on their own initiative or as a result of solicitation from a potential tenant should carefully consider the character and reputation of the tenant, the nature of the product or services proposed to be offered, and the compatibility of the tenant and its services with the image the bank seeks to portray in its community. Contract terms and indemnifications notwithstanding, the bank's reputation will be tied, favorably or unfavorably, to its tenants.

Each bank should have any proposed contracts reviewed by its own legal counsel and approved by its board. The following specific points should be considered:

1. Although the sharing of employees is not prohibited, separate employees are preferred for the sales and marketing of non-insured products. If the employee has other duties, those duties should not include the opening of deposit accounts or the acceptance of insured deposits. Prescribed limits on a bank's employees involved in non-insured investment activities should establish a clear separation between insured deposit activities of the bank and any non-insured investment activities. Shared employee arrangements can create major problems in accountability, employee relations, bonding, supervisory responsibility and customer perspective. In view of this fact these areas should be thoroughly addressed (contractually or in written policies and procedures), to assure the bank is adequately protected and to assure the absence of conflict of interest if shared employees are contemplated.

2. The tenant should be responsible for all expenses associated with its operation with the only financial relationship between the tenant's business and the bank being the agreed upon rental payments.

3. Direct compensation of bank personnel related to the presence of the tenant is discouraged. Any such arrangements must insure the absence of conflicts of interest.

4. The leased space and the tenant's records must be physically separate from the bank's work area and banking records although shared public areas might be arranged. Tenant employees should not have access to bank work areas or records.

5. Bank management should clearly understand the implications of the arrangement under the bank's blanket bond coverage and provide in the lease contract for supplemental coverage from the tenant to fill any exposure gaps created by the arrangement.

6. The bank should require proof of appropriate licensing of the tenants activity; i.e., registration with the State Securities Commissioner, licensing by the State Insurance Commissioner, proper local business licensure, etc.

7. Where banking areas are not secure and separate from tenant space, tenant hours must be consistent with banking hours.

It is clear that while many vendors may have services or products a bank wishes to make available to its customers, the motivation of the vendor is to enter or expand its presence in the market by utilizing the bank's customer base, accessed through lobby traffic exposure or mail inserts, and the bank's marketing effort and image. Bank management must assure that customer confidentiality, bank security, and the bank's market image are not compromised by the potential profits to be realized. Policies on this subject by appropriate federal regulators should also be reviewed.

# SALE OF NON-INSURED INVESTMENT PRODUCTS BY GEORGIA STATE-CHARTERED BANKS

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This policy statement is designed to give guidance to Georgia State-Chartered banks planning to offer non-insured investments such as mutual funds and annuities to their customers. The sale of these products on the bank's premises or through a bank's affiliate may pose a financial risk to the institution which must be properly managed to avoid adverse safety and soundness implications on the bank. Banks utilizing any program involving leased space by non-affiliated third parties should also utilize the policy statement: "Leasing of Bank Premises to Non-Affiliated Enterprises for the Purpose of Providing Goods or Services to Bank Customers". All references herein to "non-insured" shall mean investments not insured by FDIC.

## PROCEDURES

Any non-insured investment product sales programs should be implemented using sound written policies and procedures which are reviewed and updated on a regular basis. The bank's board of directors should review the effectiveness of the program at least annually. Written policies and procedures should address the following:

1. Written contracts relative to all non-insured investment products should be reviewed by the bank's legal counsel and be approved by the bank’s board of directors prior to implementation.

2. Prescribed limits on a bank's employees involved in non-insured investment activities should establish a clear separation between insured deposit activities of the bank and any non-insured investment activities. Although the sharing of employees is not prohibited, separate employees are preferred for the sales and marketing of non-insured products. If the employee has other duties, those duties should not include the opening of deposit accounts or the acceptance of insured deposits. Employees directly involved with non-insured investment products should be appropriately licensed by the regulatory body having jurisdiction over such products or activities, and should receive adequate training, appropriate for the level of involvement with non-insured investment products or activities.

3. The activities and compensation of bank employees engaged in the sale, or referral to sales representatives of non-insured investments, should be covered by specific written policies which insure the absence of conflicts of interest.

4. Sales and marketing areas for non-insured products should be physically separate from other bank activities. This area should prominently identify any third parties which may be offering non-insured products to bank customers.

5. Prior to engaging in non-insured investment activities, the bank's board of directors should review the applicability and adequacy of the bank's fidelity coverage with respect to such activities. Subsequent reviews should be conducted annually, and all reviews should be documented in writing.

6. For all non-insured investments, adequate disclosures should be made at the time of sale and when any written statements relative to those investments are rendered to the customer by the bank. At the time the non-insured investment account is opened by a bank's customer, the bank should obtain a written acknowledgment from the customer that he/she understands the investments are not deposits, are not insured by the FDIC, are not guaranteed by the bank, and that the market value of the investments will fluctuate and that the loss of principal invested may result. An original copy of the signed customer acknowledgment should be maintained by the bank with a copy provided to the customer.

7. Prior to engaging in non-insured investment activities, the bank should verify that all required licenses are obtained. At least annually thereafter, the bank should verify that all such required licenses continue to remain valid.

# PURCHASE OF BANK OWNED LIFE INSURANCE (BOLI) PRODUCTS BY GEORGIA STATE-CHARTERED BANKS

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LEGAL AUTHORITY FOR BANKS TO PURCHASE BOLI PRODUCTS

The General Corporate Power provisions of O.C.G.A. contained in §7-1-260 include in Section (9) the following:

> "To procure, for its benefit, insurance on the life of any of its directors, officers or employees or any other person whose death might cause financial loss to the bank or trust company; or, pursuant to any contract lawfully obligating the bank or trust company as guarantor or surety, on the life of the principal obligor."

Additionally, O.C.G.A §7-1-261 provides for incidental powers. The Department believes that the General Corporate Powers under §7-1-260 and the incidental powers provisions contained under §7-1-261 would authorize the purchase of BOLI insurance policies by banks, provided that all necessary safety and soundness considerations are met in the purchase of these products. It would not be anticipated that specific or prior Department approval would be necessary to purchase these products, except as noted below in the discussion of safety and soundness issues.

Safety and soundness factors must be primary considerations in the purchase of BOLI products. These include several specific safety and soundness factors that should be actively monitored and reviewed in the consideration of these products during the examination and supervision process as noted below:

De novo Institutions

The Department has a substantial number of financial institutions that have been in business for three years or less. Several of these institutions have contacted the Department, along with representatives of insurance companies that market BOLI products, regarding the appropriateness of these products for de novo institutions. The Department regards new banks as higher risk enterprises as compared to banks with an established operating history due to their earnings characteristics (including the lack of positive sustained earnings in some cases), lack of a sustained and proven business plan model, and constraints on providing additional capitalization and other uncertainties. The Department, therefore, would expect that such products would need to be demonstrated to be appropriate and non-detrimental to the bank, appropriate to the earnings and capital position of the bank and consistent with the business plan for the bank. Normally such a contractual obligation should receive prior Department approval during the bank's first three years of operations.

Problem Institutions

It may not be appropriate for financial institutions with problem characteristics, particularly those subject to administrative actions, to purchase BOLI products, depending upon the nature or severity of the problems. Banks with asset quality or earnings issues, asset/liability mismatches or insufficient liquidity or capital might find these problems exacerbated by the purchase of certain BOLI products. The Department might specifically require the approval of the purchase of such products as a condition of a Board Resolution, Memorandum of Understanding, or Cease and Desist Order.

Issues regarding Excessive Compensation or Insider Abuse

In evaluating BOLI products, institutions should make certain that the purchase of such products, when combined with other forms of compensation paid to bank officers, does not represent excessive compensation. Part 30 of Title 12 of the Code of Federal Regulations addresses safety and soundness standards, and contained within Appendix A to this regulation is a section prohibiting excessive compensation as an unsafe and unsound practice. Excessive compensation is based on a determination of the reasonableness of the benefit being provided by the BOLI, the reasonableness of the cost of providing that benefit and the reasonableness of total compensation being provided, including the benefits provided through the BOLI products.

Additionally, the use of BOLI would not be appropriate if the use of the product represented insider abuse, fraud, or breach of trust, or if the use of such products could lead to material financial loss for the institution.

Other Safety and Soundness issues related to BOLI products

Additional factors might be identified as supervisory concerns during the examination process if it were determined that these were material safety and soundness risks to the bank. These concerns might include the following:

1. Substantial surrender charges on the BOLI products that effectively "lock in" the bank to the product.

2. The financial strength of the insurance company offering the BOLI products.

3. The bank failing to properly meet the provisions of GAAP in accounting for these products.

4. The bank purchasing BOLI products on individuals other than "Key Persons," unless the product is otherwise demonstrated to be appropriate.

5. Failure to meet other applicable regulatory compliance issues, including FDIC Rules and Regulations and Federal Reserve Regulation O.

6. The product appearing to present the bank with potentially adverse tax consequences.

7. Policy endorsements and assignments required not being properly executed.

8. BOLI products representing potential legal concerns with minority shareholders.

**INTERAGENCY STATEMENT ON THE PURCHASE AND RISK MANAGEMENT OF LIFE INSURANCE (FDIC FIL-127-2004)**

On December 7, 2004, an Interagency Policy Statement was issued to provide guidance for institutions purchasing life insurance. This new Statement is more detailed than OCC Bulletin 2000-23, which the Department had previously adopted, but the banker's responsibilities with regard to the purchase of life insurance remain basically the same. There should be appropriate Board and senior management oversight of the risks involved in the purchase of life insurance, appropriate analysis and vendor assessment before the purchase and during the holding period, and the insurance should be properly accounted for on the bank's books. (For additional accounting guidance with regard to insurance policies purchased in connection with deferred compensation arrangements, reference should be made to FDIC FIL-16-2004, "Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-Owned Life Insurance").

Banks should avoid investing a significant percentage of capital in such life insurance policies. When establishing internal limitations for such policies on an individual and aggregate basis, the institution's lending limitations and capital concentration threshold should be considered. The Policy Statement recommends that institutions utilize the concentration threshold of 25 percent of Tier 1 capital as a benchmark when establishing internal limitations for the aggregate cash surrender value of all policies purchased. Generally, holdings above this concentration limit will receive additional scrutiny and require justification on the part of the bank's Board.

Purchases of life insurance made on or after December 7, 2004 should be made in accordance with this Policy Statement. Deviations which represent significant safety and soundness concerns may subject the bank to criticism and possibly administrative action during examinations. Each situation where the BOLI product was in conformity with standards at the time of purchase and subsequently moved outside of these standards due to changes in the cash surrender value or changes in the financial institution's capital, will be evaluated independently in order to determine a course of action based upon the extent of any safety and soundness concerns.

SUMMARY OF THE DEPARTMENT'S POSITION ON THE PURCHASE OF BOLI PRODUCTS

To summarize our Department's position on the purchase of BOLI products, we focus on the safety and soundness implications of BOLI purchases, utilizing the guidance contained within the Interagency Policy Statement on the Purchase and Risk Management of Life Insurance. Special Supervisory emphasis and attention is placed on purchases of these products by de novo financial institutions or problem financial institutions due to the risk characteristics of these banks. The purchase of BOLI products should not represent excessive compensation to executive officers and such arrangements should not reflect an abusive insider situation that could adversely impact the bank.

We recognize that there is a need for such products particularly in providing executive retirement plans needed to retain key executive officers. It has been our experience that the majority of BOLI plans that we have reviewed have not represented undue risk to the financial institutions purchasing the products and that companies offering these products have not sold products to banks that would be improper or detrimental to the safety and soundness condition of the institution.

We do believe that safety and soundness benchmarks are needed to maintain diversification and moderation of risk, and our position on these issues is outlined above. The Department would regard purchases of BOLI from one issuer in excess of the Georgia statutory lending limits or aggregate purchases of BOLI in excess of the concentration of credit guidelines to be potentially problematic and subject to adverse regulatory comment. While there are no statutory limitations regarding the purchase of BOLI products, we generally expect compliance with safety and soundness provisions outlined above and detailed in the Policy Statement in order to limit potential financial and operating risk to the bank or financial institution.

# DEBT CANCELLATION CONTRACTS AND DEBT SUSPENSION AGREEMENTS

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## DEFINITIONS

**A Debt Cancellation Contract** is a contractual agreement modifying loan terms that is linked to a bank or credit union's extension of credit, under which the bank or credit union agrees to cancel all or part of a customer's obligation to repay an extension of credit from that financial institution upon the occurrence of a specified event.

**A Debt Suspension Agreement** is a contractual agreement that modifies loan terms that is linked to an extension of credit, wherein the financial institution agrees to suspend all or part of a customer's obligation to repay an extension of credit upon the occurrence of some specified event.

Typically these products are tied to the life, injury or disability of the borrower, although some products are based on the occurrence of some other specified event, such as termination of employment.

Fees are assessed to the borrower for the ability to cancel or suspend loan payments on the loan, in accordance with the terms of the agreement.

## STATUS OF DCCs AND DSAs UNDER GEORGIA LAW AND REGULATIONS

Georgia law does not specifically discuss DCCs and DSAs. They are clearly covered, however, by the following laws and rules. The law provides in part, in §7-1-261(11), that financial institutions have powers to carry on banking activities that are determined by the Commissioner to be financial in nature or complementary to such financial activities. Code §7-1-72 addresses the regulation of third parties who provide financial services to state chartered financial institutions. Also, §7-1-61(a)(1) authorizes the Department to make rules and regulations to enable state financial institutions to compete fairly with other providers. The Department has adopted rules permitting the underwriting and sale of DCCs and DSAs. Specifically, Rule 80-1-2-.09 governs DCCs and DSAs offered by state-chartered financial institutions.

Insurance Commissioner John Oxendine has agreed that these products are not insurance and that financial institutions may underwrite market and sell them with no approval or license from the Department of Insurance. Should an institution wish to transfer the risk to a third party insurer, that insurer of course must be licensed. Since national banks are able to provide these products, the Department issues this policy guidance, replacing the policy statement issued on September 9, 2002, on DCCs and DSAs.

Parity is an essential element for a healthy dual chartering system. The Office of the Comptroller of the Currency has established in their interpretation of federal statute and through the establishment of specific Rules (66 FR 19901) that national banks have the authority to enter into DCC or DSA agreements with their customers. The NCUA includes the issuance of DCC and DSA products to be within the definition of their incidental powers provisions under Part 721 of NCUA Rules and Regulations for federal credit unions. Further the Department has reviewed two legal opinions by NCUA, one dated September 12, 1997 and the other dated December 23, 2002, which specifically discuss the ability of federal credit unions to offer these products. It is the determination of the Department of Banking and Finance that these products are permissible for Georgia state chartered banks and credit unions, subject to certain policy provisions of the Department related to institutional safety and soundness and certain safeguards to assure that the features of these products are not harmful or misleading to bank or credit union customers or members. These products, if offered by banks and credit unions are not subject to the provisions of state insurance laws.

Consequently, the Commissioner has determined that DCCs and DSAs constitute activities that are financial in nature and that state financial institutions may conduct these activities in accordance with the policy guidance and Department rules.

## PROCEDURES FOR INSTITUTIONS OFFERING DCC OR DSA PRODUCTS

State chartered banks and credit unions that desire to offer DCC or DSA products should notify the Department in writing that they intend to offer such products. The following information, at a minimum, should be maintained in the financial institution to be available for review by Department and federal agency examiners, auditors and others:

- The types of contracts that are to be offered and the appropriate underwriting standards for each product.
- Written policies and procedures developed regarding DCC or DSA products.

- A listing of any vendor or servicer being used in conjunction with the product offerings and the services these vendors will be providing to the financial institution.
- The bank or credit union's plans to adequately administer claims, especially on disability and unemployment coverage.
- Risk evaluation and appropriate mitigation procedures, including any plans for re-insurance.
- The projected impact on bank or credit union staffing of offering DCC or DSA products.

**Financial Institutions wishing to Underwrite and Take on the Risk of DCC or DSA Products**

It is not anticipated that many financial institutions will choose to fully underwrite and take on the risk of DCC or DSA products. Some institutions may choose to take on a segment of the risk of these products and partner with an insurance company to "reinsure" the risks in excess of this segment of risk. An institution wishing to underwrite and take on the risk of a DCC or DSA product would require Department approval and would need to demonstrate the management capabilities, resources and skill-sets to manage such risks and would be subject to a higher level of supervisory scrutiny, including analysis of the following factors:

- Management expertise should be demonstrated, based on education and experience, in the areas of product design, underwriting, actuarial analysis, claims processing and risk reserving and accounting practices to support the ability to provide these functions in-house.
- An explanation of the risk management techniques that the financial institution will undertake including product design criteria, underwriting procedures, limitations and conditions on DCC or DSA products, and other risk mitigation procedures in order to limit risk exposure to the financial institution.
- A proper and well-documented analysis of risk of the products being proposed, including the risks posed by catastrophic events that could result in unusually high claims upon the financial institution.
- The financial institution should outline their proposed practices for properly reserving for risks related to these products based on industry practices and Generally Accepted Accounting Principles.
- An analysis of the financial institution to support that the financial institution has the proper financial position, cash flow performance and capital position to sustain continued operations in the event of an unusually high claims event.

## THIRD PARTY SERVICERS

Based on discussions with financial institutions and companies involved with DCC and DSA products, it is anticipated that the majority of financial institutions will choose to utilize a third party servicer arrangement in order to provide expertise in product design, claims administration, underwriting and risk management. Most financial institutions will utilize risk management procedures to transfer most, and in some cases all, underwriting risk through a third party arrangement. Financial institutions that utilize servicers to provide assistance with the design and operation of a DCC/DSA program will be responsible for meeting the requirements contained in Rule 80-1-2-.06 of the Department or Rule 80-2-7-.02 (Rules issued in 2003) in the case of a credit union servicer. The financial institution shall be responsible for performing analysis and maintaining adequate documentation of this analysis of the servicer in the following areas:

1. The experience of the servicer in the areas that are being contracted with the financial institution. It would be anticipated that an insurance company that is operating in the State of Georgia and is otherwise regulated by the Georgia Department of Insurance regarding insurance products, would have sufficient experience to provide expertise regarding DCC or DSA products. Companies or other entities that are not insurance companies would need to demonstrate their expertise in the areas contracted for service. Any company providing insurance must be licensed by the Department of Insurance in Georgia. It should be reasonably expected that such servicers will have experience in risk underwriting, claims administration, re-insurance and other areas, depending on the services that are to be provided to banks and credit unions.

2. The financial stability of the servicer would also have to be demonstrated and documented by the financial institution. This could be supported by analysis of financial, operating or cash flow statements, analysis of capital and reserves and the use of external company ratings performed by Standard and Poors, Moodys, AM Best or other valid external rating agencies. Any servicer that is capitally insolvent or which is reflecting a net operating loss should receive additional analysis and support by the financial institution demonstrating that the servicer has adequate financial stability to service the financial institution and sufficient capitalization and cash flow to remain a going concern.

3. A copy of any written contacts between the financial institution and the servicer, detailing the services to be provided by the servicer.

4. A schedule of fees and assessments that will be charged by the servicer to the financial institution should be maintained.

5. Any reports, printouts, schedules or programs that will be provided by the servicer to the financial institution to permit bank management, auditors, examiners and other interested parties to monitor the services provided.

Adequate and complete documentation regarding the above due diligence should be maintained within the financial institution for review by auditors and examiners. The financial institution should periodically (at least annually) review and update this information, particularly regarding the financial stability of the servicer.

Additionally, in accordance with Rule 80-1-2-.06 (or 80-2-7-.01 in the case of credit unions) the servicer must agree in the contract with the serviced financial institution to make its books and records available for examination by the Department of Banking and Finance. The Department shall have the authority to periodically review the internal routine and controls of the servicer to ascertain that the operations are being conducted in a sound manner in keeping with financial institution industry practices and Generally Accepted Accounting Principles (O.C.G.A. §7-1-72).

## SAFETY AND SOUNDNESS CONSIDERATIONS

The Department's goal in monitoring the safety and soundness considerations of DCC and DSA products in the supervision and examination process is to make certain that the financial institution has properly analyzed the risk in their DCC and DSA product offerings, that they have established adequate controls and safeguards to limit and mitigate this risk and that they have adequate staffing in place to properly administer the program. Financial institutions shall properly account for this activity, including appropriate recognition and financial reporting of income, expenses, assets and liabilities and losses and claims associated with these products. Financial Institution shall have properly considered the ability, experience and financial stability of any vendors or servicers utilized in the offering of these products.

The safety and soundness expectations of the Department shall consider the amount of risk that the financial institution is taking on directly. Depending on this level of risk, it may be appropriate, subject to the requirements of GAAP to establish an identifiable loss reserve for these products. If such a reserve is determined not to be required under GAAP, the financial institutions shall otherwise establish risk management and control procedures to quantify the risk inherent in these products and to demonstrate that the bank or credit union is properly managing and controlling this risk.

## OTHER CONSIDERATIONS

It is important for financial institutions to have the flexibility to design products that can be offered to provide a needed service to customers or members at a reasonable price. In designing DCC or DSA products, it should be made clear to consumers any limitations, conditions or exclusions on product coverage, including the ability of the financial institution to unilaterally modify a DCC or DSA product and this contract should be signed by the borrower, acknowledging their understanding of these product features. Refer to the comment below regarding prohibited practices and disclosures.

## PROHIBITED PRACTICES

As discussed above there are certain practices which must be avoided so that these products are not harmful or misleading to customers or members. These practices unless otherwise noted below apply to banks and credit unions and subsidiaries of these financial institutions. Failure to maintain these practices shall be considered an unsafe and unsound practice, in addition to being potentially misleading to the consumer and would be subject to administrative actions as appropriate. These practices include the following:

### 1. Anti-Tying Provisions

A Georgia state chartered bank or credit union shall not extend credit or modify the terms of credit conditioned upon the purchase of a DCC or DSA product. It shall not be indicated in any representations either orally or in writing that the credit granting process is contingent or dependent upon the borrower's decision to purchase such a product.

### 2. Misleading practices and disclosures

A Georgia state chartered bank or credit union shall not engage in any practice or make any disclosures in advertising, marketing or consumer disclosures that is misleading or which could otherwise cause a reasonable person to reach an erroneous belief regarding the information contained in this material.

### 3. Unilateral Modification of DCC and DSA Contracts

A bank or credit union may not offer DCC or DSA products that contain terms giving the financial institution the right to unilaterally modify the contract unless:

a. The modification is favorable to the customer or member and is made without additional charge to the customer or member; or
b. The customer is notified of any proposed change and is provided a reasonable opportunity to cancel the contract without penalty before the change goes into effect.

4. Prohibition on Single Fee Coverage

Banks and credit unions are likewise prohibited from using a single premium or fee product for DCC or DSA coverage or in otherwise rolling the cost of this fee or premium into the balance of the loan on residential mortgage loans, unless it can be demonstrated to the Department that there are statutory, regulatory or data processing issues that would prevent a bank from using a monthly payment product.

A bank or credit union may offer a customer or member the option of paying the fee for a DCC or DSA product in a single payment (for loans other than residential mortgage loans) provided that the bank also offers the customer or member a bona fide option of paying the fee for that contract in monthly or other periodic payments. If the financial institution offers the customer the option of financing the single payment by adding the balance to the amount the customer is borrowing, the financial institution must also disclose to the customer the time period during which the customer may cancel the agreement and receive a refund.

5. Refunds in the event of termination of the agreement or prepayment of the loan

If a DCC or DSA is terminated, prepaid or otherwise cancelled prior to the maturity of the loan contact, the bank shall refund to the customer or member any unearned fees paid for the contract unless the contract provides otherwise. A financial institution may offer a customer a contract that does not provide for a refund only if the financial institution also offers that customer a bona fide option to purchase a comparable contract that provides an equitable refund feature.

An equitable refund feature is a refund that is at least as favorable to the consumer as the actuarial method. The actuarial method is a method of allocating payments made on a debt between the amount financed and the finance charge where a payment is applied first to the accumulated finance charge and any remainder subtracted from or any deficiency added to the unpaid balance of the amount financed. In no event shall refunds be permitted under DCC or DSA agreements using the Rule of 78's or any other method less favorable to the consumer than the actuarial method.

## DISCLOSURES

**Short Form Disclosures**

The financial institution shall provide the following Short Form disclosures orally at the time the bank first solicits the purchase of a DCC or DSA product, and during telephone and electronic solicitations as outlined below:

1) Disclosure that the decision to buy a DCC or DSA is optional and this decision will not affect the customer's application or terms of any existing or proposed loan (Anti-tying Provisions).
2) Disclosure of a single payment feature if applicable (prohibited for residential mortgage loans and subject to other limitations above.)
3) Disclosure if the financial institution uses a single payment feature without a refund feature (subject to the alternative product requirements outlined above.)
4) Disclosure of the terms of refund if DCC/DSA fees paid in a single payment and the program has an equitable refund feature.
5) An indication that additional disclosures are required and will be provided to the customer or member before being required to pay for a DCC or DSA product.
6) An indication that there may be eligibility requirements, limitations or exclusions under the DCC or DSA contract, the details of which will be provided in the long form disclosures.

**Long Form Disclosures**

The financial institution shall make long form disclosures in writing before the customer or member completes the purchase of the contract. If the initial solicitation occurs in person, then the financial institution shall provide the long form disclosures in writing at that time.

The financial institution shall make the following long form disclosures:

1) Disclosure that the decision to buy a DCC or DSA is optional and this decision will not affect the customer's application or terms of any existing or proposed loan (Anti-tying Provisions).

2) Explanation of the features of a debt suspension agreement (as opposed to a debt cancellation agreement) and that a DSA suspends and does not cancel the customer's obligation to pay the associated debt.
3) Disclosure of the amount of the fees for the DCC/DSA product.
4) Disclosure of a single payment feature if applicable (prohibited for residential mortgage loans and subject to other limitations above).
5) Disclosure if the financial institution uses a single payment feature without a refund feature (subject to the alternative product requirements outlined above.)
6) Disclosure of the terms of refund if DCC/DSA fees are paid in a single payment and the program has an equitable refund feature.
7) Disclosures whether the use of a credit line would be restricted or impacted by the activation of the DCC or DSA Contract.
8) A description of the Termination provisions, if applicable, of a DCC/DSA product.
9) Disclosures related to any eligibility requirements, limitations or exclusions under the DCC or DSA contract.

These disclosures may be made electronically in a manner consistent with the requirements of applicable federal and state laws regarding digital signatures including the Electronic Signatures in Global and National Commerce Act (E-Sign) 15 U.S.C. 7001 et. seq. and Georgia law at O.C.G.A. §10-12-2 et. seq.

**Disclosures in marketing materials and in telephone and electronic solicitations**
The Department shall permit disclosures in marketing materials, statement inserts, direct mail solicitations to provide short form disclosures providing that long form disclosures, as outlined above, are provided to the consumer in writing within three business days after the customer contacts the financial institution to respond to a solicitation.

In the case of telephone or other electronic solicitations, the customer or member shall be provided with a long form disclosure document in writing within three days of a solicitation where the customer has responded positively to the solicitation.

The limited initial disclosures that must be provided to the customer orally or in written form at a minimum must include all items included in the short form disclosures as outlined above. As indicated above, full disclosures must be provided to the customer in writing within three business days of the solicitation.

Disclosures in marketing materials and other marketing solicitations must be:
1) Conspicuous, clear and readily understandable.
2) Provided in a meaningful format.

**Affirmative election to purchase and ability to rescind a transaction**
The bank customer or credit union member shall be required to affirmatively elect to purchase a DCC or DSA product. This election shall be in writing except as noted below and may be included in the loan documentation or in a separate document.

The acknowledgement and election language must be conspicuous, simple, direct, and readily understandable and designed to call attention to their significance.

**Election to purchase for phone solicitations**
In the case of telephone solicitations, the customer's affirmative election to purchase may be obtained orally, provided:
- That the financial institution maintains documentation that that the customer affirmatively elected to purchase the product.
- That the required disclosures are provided to the customer or member within three business days of the solicitation.
- That a written authorization form to be signed by the customer is also mailed to the customer within three business days of the solicitation. The financial institution shall maintain documentation that it made reasonable efforts to obtain these signed documents from the customer.
- Permits the customer in the case of telephone solicitations to cancel the contract without penalty within 30 days after the bank has mailed the disclosure and written authorization form to the customer.

**Election to Purchase based on written mail inserts or other limited disclosure marketing material**
In the case of written mail inserts, or so called "take one" solicitations, the financial institution is not required to provide short form disclosures, provided that it otherwise fully complies with the requirements regarding long form disclosures. If a DCC or DSA contract is solicited by written materials that do not contain all of the long form disclosures required above, then the financial institution shall mail an acknowledgement of receipt form of these disclosures and the disclosures to the

customer within three business days, beginning on the first business day after the customer contacts the bank or otherwise responds to the solicitation.

The bank shall maintain the following documentation regarding election to purchase the product sold through written mail inserts or so called "take one" solicitations:

- Documentation to show the bank provided disclosures and an acknowledgement of receipt of these disclosures to the customer or member.
- Documentation maintained to show the financial institution made reasonable efforts to obtain the written acknowledgement of receipt form from the customer or member.
- The customer shall have the ability to cancel the purchase of the contract without penalty within 30 days after the financial institution has mailed the disclosures and the acknowledgement of receipt form to the customer or member.

If the full disclosures are provided to the customer at the time of election, the customer or member shall not, unless otherwise provided in the written contract, have the ability to rescind the contract after the date of election.

These affirmative elections and acknowledgements may be made electronically in a manner consistent with the requirements of applicable federal and state laws regarding digital signatures, including the Electronic Signatures in Global and National Commerce Act (E-SIGN). 15 U.S.C. 7001 et. seq. and Georgia law at O.C.G.A. §10-12-2 et. seq.

## PROVISIONS RELATED TO GAP COVERAGE OFFERED BY FINANCIAL INSTITUTIONS

Gap coverage products are debt cancellation or debt suspension products that protect a borrower regarding any deficiency between the outstanding loan amount and the value of collateral (normally automobiles) in the event that there is an early termination of the loan contract where there is insufficient collateral value to pay off the loan.

This product is difficult to calculate on a monthly payment basis, due to the accelerated depreciation in value of collateral early in the life of the contract and the variable nature of the net exposure under the contract over the life of the loan. After reviewing these issues carefully, the Department has determined that our requirement to offer a monthly payment alternative along with single premium coverage will be modified regarding Gap Coverage.

Effective February 28, 2007, the Department shall permit financial institutions offering GAP Coverage debt cancellation or debt suspension products to provide such coverage solely on a single premium basis. All other requirements of the Department's policy statement on Debt Cancellation Contracts and Debt Suspension Agreements shall remain in effect for these products, including the requirement that an option be provided to the consumer for a refundable premium or fee in the event of an early termination of the loan.

Other debt cancellation and debt suspension products such as those providing life or disability coverage will be unaffected by this change and will remain subject to the provisions of our Policy Statement on Debt Cancellation Contracts and Debt Suspension Agreements.