State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS

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ISGC – 2004 – 011 - DOB

Former LETTER 2004 – 011 LC (JMV)

September 10, 2004

[redacted]

RE: Out-of-State Bank Holding Company Acquisition of De Novo Commercial Bank Chartered Pursuant to RCW Title 30 — Prohibition and Alternatives

Dear Sir:

I have been asked by David Kroeger, the Director (hereinafter, "Director") of the Division of Banks (hereinafter, "Division") of the Washington State Department of Financial Institutions (hereinafter, "DFI") to interpret state law with respect to your inquiry, as follows:

> May an out-of-state bank holding company enter the State of Washington and form and operate a de novo commercial bank subsidiary chartered under the auspices of Title 30 of the Revised Code of Washington (RCW Title 30), in which the bank holding company will own fifty-one percent (51%) of the outstanding stock of the commercial bank subsidiary?

1.0 Summary Conclusion & Proposed Alternative

An out-of-state bank holding company (as defined by statute and referred to below) is prohibited from acquiring more than five percent (5%) of the stock of a Washington state-chartered commercial bank (hereinafter, "Title 30 Bank") unless the commercial bank in question has been doing business more than five (5) years. However, such an out-of-state bank holding company may immediately acquire a majority interest in a *de novo* savings bank chartered pursuant to Title 32 of the Revised Code of Washington (hereinafter, "Title 32 Bank") and then make application to the Director for conversion from a Title 32 Bank to a Title 30 Bank.

2.0 Analysis & Interpretation

2.1 Assumptions. This letter is based on the following assumptions:

- "Out-of-State Bank Holding Company" Defined. The summary conclusion above applies to an "out-of-state bank holding company" as defined under RCW 30.04230(3), which states in part:

  > "As used in this section a 'bank holding company' means a company that is a bank holding company as defined by the Bank Holding Company Act of 1956, as amended (12 U.S.C. Sec. 1841 et seq.). An 'out-of-state bank holding company' is a bank holding company that principally conducts its operations outside this state, as measured by total deposits held or controlled by its bank subsidiaries on the date on which it became a holding company."

  For purpose of this letter, the DFI has assumed that the out-of-state bank holding company in question (hereinafter, "Holding Company") meets the definitions set forth in RCW 30.04230(3), which is cited in part above.

- Prospective Parent-Subsidiary Ownership Structure. For purpose of this letter, the DFI has assumed that Holding Company is the real party in interest seeking to become a 51% (majority) shareholder of a de novo Title 30 Bank, while Washington State residents will hold the remaining outstanding stock.

- Immediate Capitalization. For purposes of this letter, the DFI has assumed that the Title 30 Bank would, immediately after incorporation, be capitalized by subscriptions from Holding Company and Washington State residents.

- Nature of Holding Company. For purposes of this letter, the DFI has assumed that Holding Company is a corporation.

2.2 Authority to Incorporate. Pursuant to RCW 30.08.010, only ***natural*** persons who are citizens of the United States may incorporate a Title 30 Bank. As a corporation, Holding Company is a ***legal*** person rather than a natural person.

2.3 Genesis of Holding Company's Interest in Title 30 Bank. It follows, then, that, if Holding Company cannot be an incorporator, the genesis of its interest in a de novo Title 30 Bank must be by ***acquisition*** of the capital stock of Title 30 Bank in exchange for paid-in capital. *See again* RCW 30.08.010.

2.4 Acquisition of Title 30 Bank Stock Limited. As set forth in subsection (2) of RCW 30.04.230 —

> "Unless the terms of this section or RCW 30.04.232 are complied with, ***an out-of-state bank holding company shall not acquire***

> ***more than five percent of the shares of the voting stock or all or substantially all of the assets of a bank,*** trust company, or national banking association ***the principal operations of which are conducted within this state***."

[Italics added.]

Further, subsection (1) of RCW 30.04.232 provides as follows:

> "In addition to an acquisition pursuant to RCW 30.04.230, ***an out-of-state bank holding company may acquire more than five percent of the voting stock or all or substantially all of the assets of a bank,*** trust company, or national banking association, ***the principal operations of which are conducted within this state, if the bank,*** trust company, or national banking association or its predecessor, ***the voting stock of which is to be acquired, shall have been conducting business for a period of not less than five years.***"

[Italics added.]

Based on the above-referenced statutory authority, Washington state law is specific and clear that Holding Company, or any other out-of-state holding company similarly situated, may not acquire more than a 5% interest in a Title 30 Bank unless that Title 30 Bank (1) conducts its principal operations in Washington and (2) has been conducting business for 5 or more years.

2.5 Legislative History & Intent. Notwithstanding the plain meaning of the statutes as set forth above, the legislative history and intent of RCW 30.04.232 also underscores the prohibition against premature entry into the State of Washington by out-of-state bank holding companies through the incorporation of and investment in de novo Title 30 Banks.

The provisions of RCW 30.04.232 (1996 Session Laws, Ch. 2, Sec. 3) were an outgrowth of the enactment by the U.S. Congress of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (hereinafter, "Riegle-Neal Act"). *See* Pub. L. No.103-328, 108 STAT. 2338 (1994) [codified in scattered sections of 12 U.S.C. (1994)]. The passage of the landmark provisions of the Riegle-Neal Act prompted the immediate past director of the DFI, John L. Bley, to commission a Working Group on Interstate Banking and Branching (hereinafter, "Interstate Working Group") composed of industry leaders for the purpose of reporting to the Washington State Legislature on what amendments to state banking law were necessary to optimize the state charter while complying with the language, spirit and intent of the Riegle-Neal Act. On September 1, 1995, the Interstate Working Group made its Report to the Chairs of the Senate and House Financial Institutions Committees Regarding Interstate Banking and Branching Issues (hereinafter, "Legislative Report").

The preamble of the Legislative Report began with a concise explication of the multiple functions of the Riegle-Neal Act, as follows:

> "The [Riegle-Neal] Act pre-empts the rights of states to prevent interstate banking; ***leaves to the states the right to impose limited conditions upon interstate banking acquisitions***; grants to national banks the right to branch across state lines subject to state permission and on limiting conditions that states are allowed to impose, and in some cases override; grants to states the right to opt out of interstate branching (for all banks, national and state-chartered); grants to each state the right to allow interstate branching prior to the date allowed under federal law; grants to national banks agency and other powers; imposes new rules on foreign banks operating in the U.S.; provides authority for states to impose certain controls over host state branches within their states; provides that state banking authorities may examine host state branches within their states; and allows state banking authorities to enter into agreements with other states respecting supervision and examination of banks operating across state lines."

[Italics added.]

In making its Legislative Report (*See* Page 3 thereof), the Interstate Working Group addressed the following issues and made the following recommendations with respect to the age requirements of state-chartered institutions before they may be acquired by out-of-state bank holding companies or other investors:

> "Issue: Should Washington require that any [Title 30] bank acquired by an out-of-state bank holding company have a minimum age? If so, what should that age be?
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> "Recommendation: Yes; ***the minimum age should be five years***.
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> "Discussion: ***Without a minimum age requirement, an out-of-state organization could cause a new bank to be formed within Washington, acquire it immediately upon formation, and effectively accomplish de novo entry into this state.*** The ability to do so would negate the prohibition on entry by establishing a de novo branch, and adversely affect franchise values by obviating the need to acquire an existing organization in order to enter the state. Currently, Washington law requires a minimum age of three years. There was some support for retaining the three year requirement; however, a majority opted for a five year period — the maximum age requirement permitted by the [Riegle-Neal] Act. See Section 8 of [Interstate Working Group] Bill Draft.
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> "Issue: Should [Title 32] savings banks be subject to a minimum age requirement?

> "Recommendation: No.
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> "Discussion: ***Acquisition of [Title 32] savings banks by out-of-state acquirers currently is not subject to a minimum age requirement. The IWG members agreed upon the recommendation that minimum age requirements be applied to commercial [Title 30] bank acquisitions only.*** See Section 28 of [Interstate Working Group] Bill Draft."

[Italics added.]

Based upon the comments of the Interstate Working Group, as set forth above and embodied in their own Interstate Working Group Bill Draft, the Washington State Legislature adopted both recommendations of the Interstate Working Group with respect to the age requirements of state-chartered institutions before they may be acquired by out-of-state bank holding companies or other investors. No clearer expression of legislative intent can be made than the Legislature's conscious decision to apply the recommendation of the Interstate Working Group and ***increase*** the age requirement from three years to five years so as to be consistent with the maximum allowed by the Riegle-Neal Act. *See* 12 U.S.C. 1831u(a)(5)(B).

2.6 Anti-Discrimination Clause Does Not Negate "Age Requirement". Subsection (2) of RCW 30.04.232 states as follows:

> "The director [of the DFI and/or the Division], consistent with 12 U.S.C. Sec. 1842(d)(2)(D),* may approve an acquisition if the standard on which the approval is based does not discriminate against out-of-state banks, out-of-state bank holding companies, or subsidiaries of those banks or holding companies."

This anti-discrimination provision was intended to prevent an uneven and discriminatory application by the Director of an "age requirement" clearly authorized by the Riegle-Neal Act. It was not intended to be used as a claim by an out-of state bank holding company to negate the

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* The relevant provisions of 12 U.S.C. 1842(d)(2), to which RCW 30.04.232(2) makes reference, state as follows:

(C) Effectiveness of State deposit caps. No provision of this subsection shall be construed as affecting the authority of any State to limit, by statute, regulation, or order, the percentage of the total amount of deposits of insured depository institutions in the State which may be held or controlled by any bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to the extent the application of such limitation does not discriminate against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

(D) Exceptions to subparagraph (B). The [Federal Reserve] Board may approve an application pursuant to paragraph (1)(A) without regard to the applicability of subparagraph (B) with respect to any State if--

(i) there is a limitation described in subparagraph (C) in a State statute, regulation, or order which has the effect of permitting a bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to control a greater percentage of total deposits of all insured depository institutions in the State than the percentage permitted under subparagraph (B); or

(ii) the acquisition is approved by the appropriate State bank supervisor of such State and the standard on which such approval is based does not have the effect of discriminating against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

"age requirement" set forth in subsection (1) of RCW 30.04.232. Regardless of any isolated reading of the language of RCW 30.04.232(2), it is clear that the Riegle-Neal Act expressly permits "age requirements" not exceeding five years and requires "responsible federal agencies" (e.g., the Federal Reserve Board, which regulates bank holding companies) to not approve acquisitions that would violate state law consistent with the maximum "age requirements" set forth in the Riegle-Neal Act. As set forth in 12USC 1831u(a)(5)(A) and (B):

> "(A) In general. The responsible [federal] agency may not approve an application pursuant to paragraph (1) that would have the effect of permitting an out-of-State bank or out-of-State bank holding company to acquire a bank in a host State that has not been in existence for the minimum period of time, if any, specified in the statutory law of the host State.
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> "(B) Special rule for State age laws specifying a period of more than 5 years. Notwithstanding subparagraph (A), the responsible agency may approve a merger transaction pursuant to paragraph (1) involving the acquisition of a bank that has been in existence at least 5 years without regard to any longer minimum period of time specified in a statutory law of the host State."

Subsection (1) of RCW 30.04.232 is thoroughly consistent with the overriding intent of the Riegle-Neal Act, as expressed in 12 USC 1831u(a)(5)(A) and (B), cited above. Therefore, the Director has been mandated by the Washington State Legislature, as set forth in RCW 30.04.232(1), to require that an out-of-state bank holding company, including Holding Company, be prohibited from acquiring more than five percent (5%) of the stock of any Title 30 Bank unless the Title 30 Bank in question has been doing business more than five (5) years.

2.7 Permissive Acquisition of Interest in a Title 32 Bank. Notwithstanding the prohibition against an out-of-state bank holding company acquiring a de novo Title 30 Bank, an out-of-state bank holding company may immediately acquire a majority interest in a *de novo* Title 32 Bank and then make application to the Director for conversion from a Title 32 Bank to a Title 30 Bank.

As stated above, the Interstate Working Group reported to the Washington State Legislature that no "age requirement" should be imposed on the acquisition of a Washington-chartered de novo savings bank by an out-of-state holding company. This recommendation was then clearly reflected in the 1996 amendments to RCW 32.32.500(1) (1996 Session Laws, Ch. 2, Sec. 28), which state, in pertinent part, as follows:

> "A savings bank may merge with, consolidate with, convert into, acquire a branch or branches of, or sell its branch or branches to . . . any holding company or subsidiary of such an institution, subject to the approval of . . . (e) if the surviving institution is to be a bank holding company or financial holding company, the

> Federal Reserve Board or its successor under 12 U.S.C. Sec. 1842 (a) and (d)."

Based on the clear legislative history, intent and language of RCW 32.32.500(1) set forth above, the Division has consistently determined since the enactment of 1996 Session Laws, Ch. 2, Sec. 28 that there are no "age requirements" for the acquisition of a majority interest of a *de novo* Title 32 Bank by an out-of-state holding company, provided that (1) the out-of-state bank holding company obtains the approval of the Federal Reserve Board (or its successor) and (2) complies with all other notice and other ministerial requirements of the DFI.

Of course, prior to such an acquisition, the Title 32 Bank must first be chartered according to all applicable application and approval requirements of the DFI as set forth in RCW Title 32 and applicable companion provisions of the Washington Administrative Code.

2.7 Conversion of Title 32 Bank to Title 30 Bank. Once a Title 32 Bank has been formed and a majority of its stock acquired by the out-of-state holding company pursuant to approval of the Federal Reserve Board, the Title 32 Bank may convert to a Title 30 Bank, provided that a there is a majority shareholder approval and all applicable provisions of RCW Chapter 30.49 have been satisfied. As set forth in RCW 32.34.010(1)

> "***A domestic savings bank formed or converted under this title may convert itself into . . . within the meaning of chapter 30.49 RCW, a resulting state bank***. The conversion shall be effected, notwithstanding any restrictions, limitations, and requirements of law:
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> . . .
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> "(b) In the case of the conversion of a stock savings bank to . . . within the meaning of chapter 30.49 RCW, a resulting state bank, by the vote of a majority of the stockholders present, in person or by proxy, at a regular or special meeting of the stockholders called for such purpose . . . ."

3.0 Concluding Remarks

The statutory standards for making the determinations above are uniformly applicable for any out-of-state holding company, similarly situated, seeking to acquire a majority interest in a de novo commercial bank or savings bank in Washington State. However, persons other than Holding Company are advised that each applicant's relevant facts and circumstances may be different; and such relevant facts, as applied to the governing law, may result in the Division reaching a conclusion different than the one set forth above.

Should you have any questions, please do not hesitate to call upon either David Kroeger at (360) 902-8747 or (206) 956-3229, or Joe Vincent at (360) 902-0516.

Sincerely,

WASHINGTON STATE
DEPARTMENT OF FINANCIAL INSTITUTIONS

By:

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