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Addressing a Proposed Business Plan within an Application or Notice

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Applications or notices to acquire control of, merge with or form a holding company over a banking organization require the Federal Reserve to consider the business plan and associated strategic risk of the organization going forward. However, in many cases filers do not provide sufficient detail for us to fulfill our requirement to review this key factor. Consequently, such applications or notices face delays in processing and even a potential barrier to approval.

Acquisitions, mergers and bank holding company formations are required to meet various statutory and regulatory factors as well as satisfy potential supervisory concerns based on the unique facts and circumstances of each proposal. One statutory factor that may be less known to potential filers is future prospects. A review of future prospects contemplates the effect such a proposal has on the safety and soundness of a firm and its ability to implement a business plan without a significant increase to its risk profile. Therefore, we consider whether changes or strategies within a proposal are viable under the organization's current and anticipated economic and operating environment. To facilitate timely processing of such an application or notice, filers should provide clear and informationally complete documentation that describes how the organization will manage any changes or new strategies within operations, management, balance sheet competition, products or performance.

Amongst the most common areas in a proposed business plan that are informationally deficient or problematic are: 1) management, 2) balance sheet composition/concentrations, and 3) overly optimistic metrics/aggressive strategies of the pro forma organization.

Management

Whether a proposed business plan includes changes or new strategies within general operations, nature of business, product offerings or personnel, the filing should sufficiently demonstrate the competence and experience of the organization's management in implementing such changes or strategies going forward. Overall operations, nature of business, or product offerings should be supported by the qualifications of senior management and the management team as well as effective risk management. In certain cases, it may be appropriate for an organization to hire individuals with the necessary qualifications to manage such changes or strategies. New members of senior management should provide a discussion of their responsibilities and qualifications. This should include a résumé or similar discussion of their preparation for the responsibilities associated with the role.

Balance Sheet Composition

An organization must be well prepared for changes in the composition of its assets and liabilities as well as concentrations resulting from a proposed transaction. Concentrations of risk within loan portfolios, liquidity or sources of funding are common issues. In general, such changes require a compensating change in risk management, and documentation submitted with such a filing should support the organization's ability to navigate the associated risks appropriately. Risk mitigants may include additional capital, liquidity or other support. In addition, a business plan should consider how an organization will manage potential changes in the composition of or concentrations within its balance sheet as the organization's economic and operating environment changes over time.

Overly Optimistic Metrics/Aggressive Strategies

These are cases in which an organization's proposed business plan is problematic because it includes overly optimistic metrics/aggressive strategies. With respect to financials, an example of concern is pro forma growth rates or earnings assumptions well beyond industry averages as well as historical performance. Strategies that are viewed unfavorably and require significant mitigation include rapid expansion or out-of-territory lending. As indicated above, a proposed business plan should be sustainable given the organization's current and anticipated economic and operating environment. In any case, it's especially problematic when an organization relies upon overly optimistic performance or aggressive strategies to support the feasibility of the proposal.

Summary

We assess the adequacy of a proposed business plan and mitigations to associated strategic risk to determine if the organization is able to implement the plan without a significant increase to its risk profile. This requires clear and informationally complete documentation of a proposed business plan submitted with the filing. For additional discussion of common issues associated with proposed business plans, please refer to the Federal Reserve System's Supervisory Letter SR 14-2 (Enhancing Transparency in the Federal Reserve's Applications Process).

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