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# **FDIC Assisted Bank Acquisition Considerations**

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**Sterne Agee Strategies Group**

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**February 3, 2010**

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Navigating the myriad of details when contemplating an FDIC-assisted bank transaction can be a daunting process. Sterne Agee's Fixed Income Strategies group includes individuals that have experienced the process and offer this guide to assist bank managers. Appendix A provides a list of operating items that require attention prior to, during, and post acquisition. The list addresses issues such as funding, investments, external and internal communications and staffing. Appendix B focuses on Federal Reserve guidelines that may be applicable as part of the merger integration. If you would like to discuss any of the items related to a specific or planned acquisition please contact your Sterne Agee Fixed Income representative to confirm a confidential meeting.

Michael Middleton  
Managing Director  
Sterne Agee  
205-949-3523

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## Appendix A

### Bank Acquisition Considerations-Sterne Agee

#### 1. Cash & Due From

- a. FRB Reserve Account Management
  - i. Each of the two banks will need to continue preparing their liquidity position report (FR2900) for the reserve reporting cycles up to the effective merger date. Following that date there should only be one report produced that encompasses the merged entities.
- b. FRB Discount Window, TT&L and Securities Safekeeping positions
  - i. Any open positions of the acquired bank will be transferred to the surviving bank's account. Forms will need to be completed under acquiring bank's name. Will need copy of FRB Board of Governors' approval of bank merger as evidence that one bank purchased the other. Acquiring Bank BOD will need to approve FRB-DW and TT&L documents. These forms will include an updated list of authorized bank staff.
- c. FRB Stock and FHLB Stock will be redeemed
  - i. FRB Stock will be redeemed by the District Bank with proceeds credited to the bank's reserve account. The combined bank will need to recalculate the amount of stock to be held based upon the merged capital accounts and purchase additional shares of stock by completing a form and sending it to the Fed.
  - ii. FHLB Stock will be redeemed if the District Bank exceeds their targeted capital level and there are no advances, LOCs or other borrowings outstanding. If there are any open credit facilities, the surviving bank must maintain an appropriate level of stock to support that amount of credit. Regardless of the level of credit provided, the District Bank may not redeem any of the acquired stock if that District Bank's capital level is below the amount mandated by the FHFBS.
- d. Interbank Funding
  - i. During the period of time prior to closing date, fed funds sold from the surviving bank to the acquired bank must be in conformance with the surviving bank's standard policies regarding credit exposure to correspondent banks.
  - ii. Following the closing date, but prior to the merger/conversion date, fed funds can be sold in unlimited quantities between the two banks as they are affiliated entities.
  - iii. Acquiring bank will need to set up intercompany G/L accounts to ensure that inter-company FF activity nets on consolidation for activity prior to merger/conversion.
- e. Due-From Banks
  - i. Acquiring bank will need to change signature cards at time of merger to add acquiring bank's staff and delete acquired bank's staff. The activity covered will need to include the movement of securities held in safekeeping, balance reporting on-line access and initiation of repetitive wire transfers to draw down excess funds from the account.
- f. Short-Term Investments
  - i. If the acquired bank holds brokered CDs as short term investments a list of key information will be needed quickly. This list should contain the issuing banks name, amount of CD, maturity date and a contact name/address. Each issuing bank must be

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contacted to provide the acquiring bank names as new owner along with the new coupon/maturity payment instructions. Further, since many banks will auto-renew CDs unless told otherwise by the customer, this contact process affords the opportunity to instruct each issuing bank to cancel the auto-renew and to send interest and principal upon maturity.

- ii. Accounting for brokered CDs held as short-term investments can be done with an excel spreadsheet if the item count is low. If the item count is high, these CDs can be set up on the bond accounting system as a new class of investment securities. This will ensure that all interest accruals and coupon/maturity payments are posted on a timely basis and reconciled promptly if not received.

## 2. *Investment Portfolio Pre Purchase Due Diligence*

- a. Prior to agreeing to purchase another bank, the acquirer needs to verify the description, market value and credit rating of every bond in the securities portfolio. Do not rely upon the information provided within their bond portfolio accounting report. It is not unusual to find that descriptions have been abbreviated (particularly with municipal bonds) such that it is difficult to determine if it is a general obligation, revenue or IRB (with corporate obligor) bond. Also, while certain types of bonds generally have accurate market values shown (like USTN and US Agency N/C Notes), most of the securities in the portfolio are priced using a matrix approach. Under this methodology, there can be large discrepancies between true market value and the market value shown in the report. Finally, there are certain types of bonds (non-rated municipal bonds, State of Israel bonds) that are not priced at all. Many investment portfolio accounting systems will default to the original purchase price when a bond is not priced. Therefore, the gain or loss will be shown as zero when it may in fact be far from that.
- b. NOTE: Certain bonds require special attention and must be examined extremely closely. These types of securities include: Collateralized Mortgage Obligations (CMOs) backed by non-GSE guaranteed residential or commercial loans, Collateralized Debt Obligations (CDOs), Trust Preferred stock (TRUP) issued by community banks and US Government Agency Preferred Stock. While the bonds noted above may have inaccurate prices, their errors will generally be small and within 1 or 2% of par value. The items mentioned in this paragraph can be anywhere from that level up to 90-95% of par value.
- c. It is important to obtain a list of reconciling items that explain any differences between the investment securities values on the G/L and the amounts shown on the bond accounting system. Quite often, the bank holdings of FRB, FHLB, State of Israel Bonds, private placement municipal paving certificates or certificates of indebtedness are not listed on the bond portfolio accounting system. **Every** investment security needs close examination.
- d. The three steps above are absolutely critical to follow as significant losses may be realized if the due diligence is not performed thoroughly. Once a bank has acquired another bank and agreed upon the valuation of the securities portfolio there is no going back later post-merger and renegotiating or revaluing the bonds and make adjustments to the acquisition price.
- e. As with FRB, the banks that act as custodian to safe keep the acquired bank's investment securities will need new account forms, signature cards, proof of purchase and corporate resolution (or Certificate of Incumbency) that designates the acquiring bank employee as

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empowered to sign all of the paperwork on behalf of the bank and to issue instructions relating to the movement of the investment securities.

### 3. *Liabilities-Retail*

- a. Pre-purchase analysis is important. Although the bank's retail banking or marketing area will typically be the point of contact to manage deposit product conversion, treasury needs to stay fully involved along the way to ensure that all information is communicated properly.
- b. Identify each deposit product of the acquired bank and map it to the acquired bank product. Quite often, this mapping is difficult as the acquiring bank may not have a similar product. Retail and Treasury need to compare/discuss/direct the disposition of each one. It is important to identify any deposit products that have contractual guarantees on pricing. Examples would include: a) a one-time mandatory step-up CD, b) a one-time rollover/extension option at the original rate given at start of CD that the customer can choose to exercise or not and a commercial account sweep repo or a public body money market account that re-prices on a monthly basis using a rate formula such as the US T-Bill Yield +/- X%. The acquirer should identify any deposits (or sweeps) that have "special" rate pricing and the customer associated with it to understand why they receive the rate. For example, there may be a small balance account receiving a special rate because it is a law firm that directs escrow deposits to the bank's trust department. It's important to know the customer background prior to moving the customer back to standard pricing.
- c. The acquiring bank should conduct a rate shop of local competitors to identify how the acquired bank ranks relative to the others. Determine if the bank pays in the first, second, third or fourth quartile to understand the pricing power of the bank relative to deposit retention. There can be times where the acquired bank was paying rates in the upper end of the first quartile. It may be that the acquiring bank can reduce the deposit rates and still remain at the top of the market.
- d. Post acquisition deposit runoff is very different for a FDIC assisted transaction than a normal merger of two going concerns. Generally speaking, a regular bank acquisition will hold deposits if the acquired bank's rates are left unchanged. An FDIC assisted bank may lose substantial amount of deposits regardless of the rates paid by the acquiring bank. Much of this deposit runoff can occur immediately prior to the actual closing/acquisition date. Rumors of an imminent bank failure in local community can cause customers to withdraw their funds and move them to another financial institution or their brokerage accounts. This runoff can continue immediately following the acquisition by a healthy bank if that bank's financial health and reputation are unknown.
- e. Immediately following the acquisition of an FDIC bank, it is absolutely critical that the acquiring bank get the word out about their safety and soundness. There will be a window of time within which the deposits that left can be brought back. However, the longer the funds remains elsewhere, the harder it will be to bring them back.

### 4. *Liabilities-Wholesale*

- a. Wholesale funding is credit sensitive. Any wholesale funding that could leave will have already left by the time of acquisition. This would include correspondent bank fed funds credit lines and/or BHC credit lines. Further, while customer sweep repo rolls up in the G/L chart of accounts as Short-Term Borrowings and lumped with wholesale funding, most bankers think of that funding source as part of their core business. However, as seen in the aftermath of the financial

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system stress in 2009, customers will withdraw funds from a bank's sweep repo even though the deposits are collateralized. When a banker explains to the corporate customer that their repo is exempt from the automatic stay provisions of the US Bankruptcy Code and their funds are therefore protected, that will fall on deaf ears and a portion of the repo book will leave the bank. Similarly, public funds secured by investments securities will also leave the bank in spite of a protected position. As with the customer deposit runoff, there may be opportunities to repatriate these customer "wholesale" liabilities if handled properly by the acquiring bank.

- b. As noted above, when a bank acquisition is a FDIC-assisted transaction there will be very little wholesale borrowings except for any outstanding FHLB Advances or Brokered CDs.

#### 5. *Liquidity*

- a. The acquired bank will have had collateral haircuts adjusted to reflect higher credit risk and lower credit availability as creditors such as the FHLB and FRB reduce the level of funds that they will provide to the bank given a certain level of collateral. That reduction of liquidity will be restored post-acquisition as the acquiring bank will only be required to maintain normal collateral haircuts. Therefore, bank liquidity relative to collateral should improve post merger without any other factors involved.
- b. The Treasury area should review deposit data on a daily basis. It is better to see the raw numbers directly rather than wait for a report at a weekly meeting or rely upon someone else to update the status regularly. It is important to get underneath the numbers to understand if the deposit flows are meaningful. Seasonality can influence the numbers. For example, many banks experience retail deposit outflows in December while public fund customers build deposits going into year end. Also, one can review a report on closed accounts and conclude that it is not troublesome as the accounts all maintained small balances of <\$250. However, tracking the accounts on a monthly basis for the twelve months prior to closing may reveal that all of the accounts used to maintain balances >\$250,000 and were drawn down slowly until closed with small balances.
- c. Communication with regional managers and branch managers is crucial. The line management will have a feel for the tone of the deposit flow that looking at numbers on reports will not reveal. These managers will also know which significant depositors are contemplating leaving the bank. This real time information provides an opportunity to engage in a systematic calling effort by the bank management to visit these customers and help them get comfortable with the financial health of the acquiring bank.

#### 6. *Accounting Issue#1: Market Value Accounting of Acquisition*

- a. All assets and liabilities will be marked to market as part of the bank acquisition. This includes all loans, investments and deposits. Differences between market values and book values will be recorded in a valuation allowance account.
- b. All of the yields on management net interest margin reports will change to reflect the MTM effect of the acquisition. Loans and deposits are processed on mainframe and will continue to generate the usual amounts of interest income/expense each month. However, the corporate accounting department will be manually processing entries related to the MTM adjustments that will bring the yields on the NIM report to their MTM levels. These adjusting entries will need to be made by corporate accounting as mainframe systems do not account for amortization or accretion of premiums and discounts. Investment securities do not have this problem as they tend to be run on

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- desktop accounting systems that easily account for premiums and discounts. Therefore, the acquired bank's bonds will be booked on the acquiring bank's securities accounting system at the new market levels as if they were purchased in the market on the acquisition date at their market price. Therefore, the acquiring bank will need to decide if the newly acquired bonds fit within their established investment policy and practices. If they do not, it is an opportune time to sell the securities with no gain or loss and repurchase securities that fit with current purchase activity. There will be no gain or loss as the bonds were marked to market on the acquisition date with the difference going to the valuation account. The new book basis is current market value so if the bond is sold quickly, there should be no gain or loss on the sale. If the bank chooses to hold the securities for several months and then sell them, there would be a gain or loss on sale based upon the difference between market value at bank acquisition and the market value at time of sale.
- c. Another example of this accounting impact can be found on the liability side of the balance sheet when looking at FHLB advances. In normal circumstances, if current advance rates are lower than the booked advance rates a prepayment penalty will be incurred if the funding is terminated prior to maturity. However, the advance will be MTM at acquisition. The difference between book and market will be posted to the valuation allowance account. If the advance is terminated immediately following the acquisition, there will be no loss booked to reported earnings at that time. Alternatively, should the acquiring bank choose to hold the advance, the cost of funds will be reflected in the NIM report as the new, lower MTM yield from date of acquisition. While it is possible to set up FHLB advances on an investment portfolio accounting system, due to the low item count generally found at banks, the adjustments are managed by the corporate accounting department in the same manner as the loan and deposit adjustments.
  - d. Ensuring an accurate MTM of the Balance Sheet is critical. Many banks rely upon their market value of equity (MVE) model for loan and deposit valuations. The degree of accuracy is not necessarily precise, but is generally within a reasonable range. It is helpful to recall that the MVE calculation is an economic approach based on present values of future cash flows. There is no additional value given to the deposits as a source of profit for future periods (i.e.-there is no "deposit premium" included). This loan and deposit valuation range can be validated with the assistance of the acquiring bank's outside accounting firm.
  - e. While a degree of leeway is inevitable when valuing loans and deposits, the investment securities can be valued with a high degree of precision. It is critical to validate the market prices on investment securities as provided to the acquiring bank from the FDIC. The reports given to the acquiring bank have been developed from the acquired bank's third party provider. Bond accounting vendors use external pricing sources from data vendors such as IDC for bond values. For mainstream products like UST the prices are very accurate. For municipal bonds, they are matrix priced and are less accurate but within a reasonable range. For corporate bonds and particularly whole loan backed CMOs and trust preferred securities, the prices can be off by a significant amount. Any challenges regarding market values on a FDIC assisted acquisition need to be addressed immediately at time of acquisition.

#### 7. Accounting Issue#2: Ordinary Accounting Entries

- a. It is imperative that the acquiring bank instruct the acquired bank to notify their investment portfolio vendor that a month-to-date run needs to be performed as of the night of the legal

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- acquisition date. This is important as the acquiring bank's accounting department will begin handling the daily accounting of the bond portfolio from the acquisition date forward to the first month-end. So, a month-to-date (MTD) run made by the acquired banks processor from the 1<sup>st</sup> to the acquisition date, and then a MTD run made by the acquiring banks processor from the acquisition date to month end will be needed to generate the proper interest income receivables entries for interest coupon accruals, the amortization/accretion entries, and any maturities, calls, purchases or sales.
- b. The tax department will want to maintain records of the original settlement date and price of certain investment securities held by the acquired bank. Bonds purchased at a discount will be accreted over life as GAAP reported earnings when added to the coupon income. However, federal income tax is not due on the accretion until the year in which the bond matures. Bonds purchased at a premium do not have any special tax considerations. The acquiring bank will need to be very careful when transferring the investment portfolio accounting from one vendor to another as they may lose the discount bonds' tax basis if not careful.
  - c. Most investment portfolio conversions consist of having the acquired banks bonds "bought onto" the new accounting system as of the acquisition date and at the market value of the bonds on acquisition date. Doing so will lose the tax basis. However, a workaround can be developed. The acquiring bank needs to request that their accounting vendor to create a "new" portfolio of discount taxable securities and municipal bonds with original issue discount (OID). This "tax basis" portfolio would be run separately from the regular portfolio which has been marked to market and is the source for general ledger entries. The "tax basis" portfolio would not have any G/L entries made from it. The tax department would be the only recipient of the report and use it to calculate tax liabilities due when bonds mature.
  - d. Many acquiring banks chose to sell the entire investment portfolio of the acquired bank shortly after the merger date. One of the convenient side benefits is that the tax accounting issue goes away when the bonds are sold.
8. *Securities Pledging-Operational Issues*
- a. If the acquiring bank intends to sell the investment holdings of the acquired bank immediately following merger, then pledging issues need to be addressed prior to the acquisition date. In cases where the investment portfolio of the acquired bank has little or no free/unpledged securities, the acquiring bank may need to sell fed funds to that bank. This would be necessary so that the acquired bank can purchase new securities to provide as collateral in substitution of the pledged securities to be sold. There are several different categories of pledges that are commonly found in all banks. They are found below. In all cases, it is a manual process to contact each customer that holds a pledge and request that they release and accept in substitution the newly purchased bonds. This approval will need to be put in a letter by the customer and sent to the custodian that holds the collateral. This process can take one week to two weeks to complete, depending upon how many customers require contact. Finally, if the acquired banks securities are to be sold immediately upon merger date, this can still be affected regardless of the pledging issues. At the time the bonds are sold simply stipulate to the dealer that a non-standard, delayed delivery will be required to allow time for the pledges to be released. That is a reasonable request that is easily accommodated by the dealer. It is important to notify the dealer of that extended settlement date prior to the time of sale.

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- b. Pledge categories:
  - i. Public Funds (PF) Pledging to Specific PF customers (as is found in LA/TX)
  - ii. PF Pledging to State Run Pools of Collateral (as is found in FL/MS/AL)
  - iii. FHLB-Securities and/or Loans pledged to secure advances and letters of credit
  - iv. FRB-Securities and/or Loans pledged to secure Discount Window (DW) borrowing or Treasury Tax & Loan (TT&L) accounts

#### 9. *Post Acquisition Timeline*

- a. The timeline utilized for an acquisition of a going concern is different than that of an FDIC assisted transaction. When a bank acquires a going concern, it is usually at a premium to book value. Therefore, the propensity is to move immediately after the deal closes to reduce operating expense through staff reduction and reduce interest expense through deposit pricing. Doing both too quickly can result in less than desired conversion issues and a significant loss of the deposits on which a premium was just paid. The motivation to do everything immediately upon acquisition does not necessarily exist in a FDIC assisted bank acquisition.
- b. An FDIC transaction is often priced such that it is immediately accretive to earnings/capital, with very little retained credit risk from the loan portfolio. Generally speaking, it also has a reasonable net interest margin. The acquisition is so accretive to earnings that the acquiring bank has the benefit of taking time to make strategic decisions regarding headcount and deposit pricing without impacting the pre-purchase cost/benefit analysis to a meaningful degree. This in not to say that the conversion should proceed on a relaxed basis, only that it should proceed promptly while taking time to make thoughtful decisions along the way.

#### 10. *Communication*

- a. Internal communication on a continuous basis within acquiring bank is critical as was noted above. The treasury manager should not assume that they will be notified promptly of any issues that present themselves. Every area of the acquired bank will be fully engaged in their role in the conversion and may not communicate to treasury as well as they normally do. It is incumbent upon the treasury manager to reach out and check the progress of the conversion. While many issues are obvious (such as wire transfer and check processing) there are others that can be very subtle (such as float availability or cash servicing of ATMs).
- b. Pre-merger communication with the acquired bank management on a regular basis is also critical. It is best not to assume that they know to continue certain practices post acquisition (such as deposit rate shopping). In the absence of any contact with the bank to be acquired, they will tend to assume that the acquiring bank will pick up all of the operations immediately upon merger.
- c. External communication with regulatory agencies, rating agencies, providers of wholesale credit, and correspondent banks is very important. It is important to convey that the acquiring bank has a detailed action plan that is well thought out, has a timetable to complete all integration issues and has the management in place to execute all elements of that plan in an effective manner.

#### 11. *Staffing*

- a. The accounting staff is critical to the acquisition integration being successful. The treasurer should work with the human resources director prior to the acquisition to ensure that there will be adequate staff to assist with the sale and delivery of the investment portfolio. This activity

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- includes assisting in the release and substitution of securities pledged to the FRB DW and TT&L, FHLB, and any public funds deposits.
- b. Typically, the Controller is considered to be a key individual and kept on the payroll for some period of time after the acquisition. This can be very important as that person has the organizational memory as to why certain things were done in the past or who is responsible for what within the accounting area.

#### 12. *3<sup>rd</sup> Party Vendors*

- a. It is important to consider what treasury work is performed by outside vendors and work internally with the point person who has been designated as coordinator of 3<sup>rd</sup> party vendor contracts. Examples of such contracts might include physical investment securities processing, check processing, wire transfer, and investment portfolio accounting. Treasury should let the coordinator know that the bank will no longer be in need of those services as they will be performed by the acquiring banks vendors.

## Appendix B Merger Guidelines-Federal Reserve Bank of Atlanta

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## Appendix B

### Merger Guidelines-Federal Reserve Bank of Atlanta

<b>Merger Issues</b>
<p><b><u>Regulatory Approval:</u></b> Federal Reserve Bank (FRB) policy states that system changes will be made only after the merger has been officially approved by all appropriate authorities and evidence of this approval has been received by the FRB.</p>
<p><b><u>Survivor and Non-survivor Information:</u></b></p> <p><b><u>Disposition of Non-Survivor Account(s):</u></b> Depository institutions are expected to close the non-survivor account(s) or convert it to a subaccount(s) at the effective date of the merger.</p> <p><i>An Accounting Information Services (AIS) Agreement will be required for changes in the provision of accounting information services to the master account and/or any subaccounts.</i></p> <p><i>Institutions may elect to leave the non-survivor account(s) open for a transition period of up to one year following the merger date. The alternative of leaving the non-survivor account(s) open is offered as an accommodation for exception situations. As such, each non-survivor account held open will need to be managed as an independent account for the duration of the transition period.</i></p> <p><b>Will the non-survivor’s name change? If there is a name change, please list in this section.</b></p>
<p><b><u>Merger Contacts:</u></b></p>
<p><b><u>Legal Date of Merger:</u></b> Provide the merger date, indicating whether it is effective as of the opening or the close of business.</p>
<p><b><u>Structure Changes of Survivor:</u></b> Provide a complete, post-merger list of branches if the survivor is a bank. If either the survivor or non-survivor is an affiliate of a bank holding company, the bank holding company is required to report <i>The Bank Holding Company Report of Changes in Investments and Activities (FR Y-10) within 30 days of the effective merger date.</i></p>
<p><b><u>Federal Reserve Bank Stock (for State Member or National Banks only):</u></b> <i>All Federal Reserve Stock must be held at the FRB where the surviving account is located.</i></p>
<p><b><u>Regulatory Reports:</u></b> For bank mergers only, indicate whether the merger will be a purchase acquisition or a pooling of interests. <i>The survivor will file regulatory reports on a combined basis (Consolidated Reports of Condition and Income, Report of Selected Assets, Report of Deposits - FR 2900 or FR 2910, etc.) on the first day the DI is a combined entity.</i> The survivor and the non-survivor should file separately on the day of the merger if it is effective as of the close of business and should file on a combined basis if it is effective as of the opening of business. See Item 8, Required Reserves for additional information on deposits reporting and reserves maintenance.</p>

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## Merger Issues

**Reserve Requirement:** *Effective the date of the merger, the merged entity will file one consolidated FR2900 report and balances held in the survivor's master account will be responsible for satisfying the consolidated reserve requirement.* The survivor will need to consider the vault cash of the non-survivor(s) when determining the merged entity's reserve position for the maintenance period immediately following the merger date. The survivor will receive one reserve liability exemption and one low reserve tranche adjustment. Consult your Reserve Maintenance Manual for further instructions regarding calculating reserve requirements after the merger date.

**Clearing Balance Requirements / Earnings Credits:** The merged entity will be allowed to maintain one clearing balance requirement in the survivor's master account. Clearing balance requirements are not established or maintained for subaccounts. The surviving entity may wish to establish or increase a clearing balance requirement to compensate for the loss of earnings credits accrued from a non-survivor's clearing balance requirement.

*A one-time transfer of excess earnings credits from the non-survivor to the survivor will be made at the time the non-survivor's account is closed or converted to a subaccount.*

*If the non-surviving account is held open for a transition period following the merger, clearing balance requirements of the non-survivor should be maintained for the duration of the transition period.*

*As-of adjustments generated in the non-survivor account(s) may not be transferred to the survivor's master account or vice versa during the transition period.*

*Earnings credits accrued in each transition account will be used to offset service charges settled in the same account.*

*Excess earnings credits may not be transferred between the surviving and non-surviving account(s) during the transition period.*

**Daylight Overdraft Monitoring/Cap Category:** The merged entity will have a single net debit cap defining its intra day credit capacity. A review of the cap category is required by the surviving institution prior to the merger and, if necessary, a resolution to establish a new cap (additional intra-day credit capacity) should be submitted. In order to establish the net debit cap for the merged entity, the survivor needs to submit a consolidated pro-forma statement of risk-based capital. The consolidated net debit cap for the merged entity will become effective at the beginning of the maintenance period following the merger date.

If the non-surviving account is held open for a transition period following the merger, the survivor's and the non-survivor's account balances will be combined for ex-post monitoring and pricing of intra-day credit under the survivor's cap category. The account balances of the survivor and non-survivor(s) will be treated separately for real-time intra-day monitoring via the Federal Reserve's Account Balance Monitoring System (ABMS).

<b>Merger Issues</b>
<p><b><u>Overnight Overdraft Monitoring:</u></b> The monitoring and, as necessary, assessment of overnight overdraft penalty charges for the merged entity will occur in the survivor’s master account.</p> <p>If a non-surviving account is held open for a transition period following the merger, the survivor’s and non-survivor’s account balances will be monitored separately. In these situations, institutions are expected to manage each individual account balance to a positive end-of-day position.</p>
<p><b><u>Discount Window:</u></b> Provide instructions for discount window collateral. Only the survivor can borrow, and it can only borrow from the Reserve Bank holding the surviving account. Interstate Branch Banks hold open a “Transition” account to accommodate the merger. Transition accounts may remain open for up to twelve months after consolidation. Review all loan documents and, if necessary, execute new agreements. If there is a change in charter, new agreements are necessary.</p>
<p><b><u>Billing Arrangements:</u></b> Charges for fee-based and priced Federal Reserve services are accumulated on a monthly cycle and assessed on a lagged basis. Institutions need to consider alternatives and, as necessary, provide instructions on the disposition of service charges generated, but not yet assessed, for the non-survivor account.</p>
<p><b><u>Correspondent/Respondents Settlement Arrangements:</u></b> Instructions concerning the disposition of existing tri-party settlement agreements (arrangements) involving the non-survivor, other depository institutions and the Federal Reserve are required. The three types of settlement arrangements, to which the non-survivor may be a party, involve settlement for Federal Reserve payment transactions, service charges, and pass-through reserve requirements. This section deals specifically with payment transaction and service charge (billing) settlement arrangements. For information on pass-through arrangements, see the section on Reserve Requirements.</p>
<p><b><u>Fedline:</u></b> Indicate the status and location of the Fedline terminal(s) for the non-survivor after the effective date of the merger.</p>
<p><b><u>Funds Transfer:</u></b> Non-surviving accounts may continue to process funds transfers until the non-surviving account is closed. Funds transfers may also be consolidated in the surviving account while the non-surviving account remains open. Provide instructions regarding the termination of the non-survivor’s funds transfer activity and third-party service provider relationships if these activities will be restricted to the surviving ABA. If non-surviving accounts are closed, funds transfers may be rejected back to the sender immediately or may be delivered and settled in the surviving account temporarily. After that time, all funds transfers will reject to the sender.</p>

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**TT&L:** Provide instructions for processing TT&L items after the merger.

If the non-survivor is in a different FR District than the survivor and wants to invest electronic tax payments in a note account, the survivor should convert the non-surviving TT&L account into a *secondary account*. The secondary account must be fully collateralized by maintaining acceptable securities with the FRB holding the secondary account. If the DI elects to maintain a single TT&L account and participates in the note option, it has two alternatives to consider: 1) a branch with a non-surviving ABA may process electronic tax payments using its own ABA, but these payments will not be invested in its TT&L account until the non-surviving account is closed or converted to a subaccount, and 2) a branch with a non-surviving ABA may process TT&L payments using the surviving ABA. To offset the decrease in funds invested in the note option account, the DI can consider increasing the maximum dollar limit on the TT&L account and becoming a direct investment participant.

If a DI uses a single TT&L account and plans to submit tax payments from branches in multiple districts, it needs to establish a separate Fedline terminal or voice response connection directly with the FRB of the surviving account to transmit Advices of Credit to that FRB. FTD coupons should be submitted to the IRS service center that services the state where the TT&L account is located..

**Book-Entry Securities:** Non-surviving accounts may continue to hold book-entry securities until the account is closed or converted to a subaccount. When the non-surviving account is closed, all book-entry securities will be listed under the surviving ABA and held at the FRB holding the surviving account. The survivor may have to obtain new pledgee or joint-custody agreements to reflect the new ABA and location of the securities, if applicable. We recommend that the survivor inform entities to which the book-entry collateral is pledged of the merger.

**Definitive Securities:** The surviving entity may continue to hold definitive securities at any Federal Reserve Office. This will not change once the new account structure becomes effective. Provide instructions as to the disposition of the non-survivor's definitive securities, if applicable. For securities pledged to Circular No. 176, the survivor must complete new agreement forms if not already on file.

**National Settlement Services (NSS)-** If the non-survivor participates in NSS verify the relationships and determine if the service will be maintained, changed, or terminated. Appropriate agreements forms must be executed

**Noncash Collections:** Non-surviving accounts may continue processing coupons sent out by the Federal Reserve to paying agents for collection. Provide instructions stating whether the non-surviving or surviving accounts (or both) will function noncash collections. The non-survivor should begin using the survivor's coupon cash letter one week before the non-surviving account is closed (not necessary if the account is left open pending conversion to a subaccount).

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**Currency and Coin:** Non-surviving entities may continue ordering and depositing cash via a non-surviving ABA. Provide a cash contact for the surviving entity and detailed instructions indicating whether 1) the same offices will continue cash services, 2) there will be any changes in the method of ordering cash (i.e., Fedline or voice response), and 3) there will be any changes in the armored carrier service after the merger.

Atlanta (404) 498-8537 (404) 498-8190 Birmingham (205) 968-6780

Jacksonville (904) 632-1090 Nashville (615) 251-7140

New Orleans (504) 593-3300 Miami (305) 471-6481

**Food Coupons:** If the non-surviving account remains open, the surviving entity may continue processing food coupons through the non-surviving accounts or may consolidate all food coupon transactions in the surviving account. Provide instructions on how to process food coupons after the merger.

**Savings Bonds:** If the non-surviving account remains open, the surviving entity may continue to process savings bonds transactions through a non-surviving ABA or may consolidate all activity in the surviving ABA. The ABA number for savings bond transactions should be provided. After the non-surviving ABA is closed, the surviving entity may need to obtain forms for a requalification as a savings bond issuing and paying agent.

**ACH:** Non-surviving accounts may continue to process ACH transactions. Provide instructions on how to handle ACH activity for both the surviving and non-surviving accounts.

**AUTOMATED NOTIFICATIONS OF CHANGE:** Fed ACH can create automated NOCs from items received by a non-survivor or obsolete routing (ABA) number in the case of mergers and acquisitions. These NOCs can only be created with a "CO2" (Incorrect Routing Number). If any additional changes are needed such as "account number", the survivor will still have to initiate the NOCs. There are no charges for this service other than the transaction fee.

**OBSOLETE ROUTING NUMBER REPORT:** Fed ACH can create a weekly report for a survivor to identify items sent to an obsolete or non-survivor Routing (ABA) Number. This report contains the information necessary for the survivor to create their own NOCs and is delivered to the servicing Reserve Bank of the survivor Routing (ABA) Number.

**SETTLEMENT AND BILLING ROLL-UP FEATURE:** You may wish to have the settlement and service billing fees rolled up to the account of the survivor or head office Routing (ABA) Number. If you choose this option, there will NOT be separate accounting entries, advices, or billing statements created for the nonsurvivor.

**NOTIFICATION OF "MERGER" ON THE COMPOSITE RECEIVER FILE (CRF):** You may have the "merged" status of a non-survivor routing (ABA) number indicated in the system-wide "Composite Receiver File" used by many originators, including Treasury, to determine the correct routing (ABA) number for any ACH participant. If you choose this option, originators may begin sending ACH items to the surviving routing (ABA) number based on the information contained in the CRF without changing account numbers.

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Please verify no "posting" problems occur that are associated with the Routing (ABA) Number change. You must be able to post items by account number only.

**DELETION OF OBSOLETE ROUTING NUMBER:** If you decide to delete a non-survivor or obsolete routing (ABA) number (volume is "0" or an acceptable level that you feel warrants deletion), you may choose this option. If this non-survivor or obsolete routing (ABA) number is deleted, ANY items (both commercial and government; debits and credits) will be rejected by the ACH operator and returned to the originating institution with an "R-13" reason code. Because of the serious consequences of this option, we strongly recommend that you exhaust all efforts to notify any originators of items to a routing (ABA) number before you delete a routing (ABA) number that is still receiving any ACH items.

### **Checks, Adjustments, and Returns:**

Provide instructions on how the following will be handled for the surviving and non-surviving institutions: forward check deposits, inclearing presentments, image deliverables, adjustments and return items (charge-backs).

Provide instructions on any electronic check presentments (MICR Presentment Service, Truncation Service, etc.) being received by either the survivor or non-survivor. Address any Check Imaging requirements in this section.

Check deposits, presentments, and adjustments can continue to be settled in a non-surviving account pending conversion to a subaccount.

*Note: The Federal Reserve Bank can only present items in the Fed zone in which the items are drawn. Arrangements can be made by the surviving institution to pick up items at the local Fed, for transportation out of the zone, if necessary, at the survivor's expense.*

**Large Return Notification:** Provide instructions stating who the FRB should notify regarding large dollar check returns of the surviving and non-surviving accounts.

**Accounting Information Services Agreement:** The agreement outlines changes a master account makes in the way Accounting Information Services are provided to itself and/or its subaccounts. This agreement must be completed and returned prior to the merger date. Please call the appropriate financial management and planning department to discuss filing the Accounting Information Services Agreement.

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