To: The Honorable Michael Schwab, Incoming Chair, Sunshine Committee
Sunshine Committee Members
Mary Tennyson, Sunshine Committee Staff

From: The Department of Financial Institutions (DFI)

Date: May 9, 2011

Re: Analysis of Proposal 2 Regarding DFI's Public Record Act Exemptions

---

On April 17, 2011, Frank Garred submitted two memoranda regarding proposed amendments to DFI's exemptions from the Public Records Act (PRA). This is a brief analysis of the second of the two proposals, herein called Proposal 2 (proposing changes to the acquisition of Washington state financial institutions by institutions with offices and branches in Washington).

I. Proposal 2

Proposal 2 broadly provides four requirements in acquisitions of a Washington state-chartered financial institutions by other financial institutions with an office or branch in Washington: 1) public inspection of applications, which must include why the bank to be acquired is offered or available for acquisition; 2) an opportunity for public comment on the acquisition; 3) public hearings on the acquisition; and 4) public inspection of DFI's final determination regarding acquisitions within six months of the determination, and no more than twelve months after filing of the application.[1]

II. Current Law

a. General Acquisitions

Most bank acquisitions are subject to federal regulations for disclosure to shareholders and the public in acquisitions and changes in control. "Reporting companies" must file quarterly

[1] The language is unclear regarding the timetable, but a reasonable reading would imply that public inspection must be available no more than six months after determination or twelve months after application.

(10Q) and annual (10K) reports, as well as major event reports (8K).[2] These reports are available to the public through the Securities and Exchange Commission (SEC) web portal, EDGAR.[3] Companies must disclose important information when soliciting proxy votes and when attempting to acquire more than 5% of a reporting company's securities. These disclosures are also available through EDGAR.

The FDIC requires Notices of Change in Control for any change in control of an insured institution (including all Washington state-chartered banks). Similarly, no person or entity may acquire control of a Washington state-chartered bank unless it files either a Notice of Change in Control or an Application for Change in Control with DFI. These applications are made under oath and require a great deal of information about both the acquiring and acquired bank. Publicly traded banks that file registration statements with the SEC may file those statements with DFI in lieu of the normal application. Once the right paperwork is filed, the Division Director of Banks has 30 days (extendable to 45 days) to disapprove a completed application based on one or more of five statutory criteria.[4] If the Director disapproves a proposed acquisition, he or she must do so in writing. The findings and order are not subject to public disclosure under the PRA unless appealed under the Washington Administrative Procedures Act, Chapter 34.05 RCW.[5]

If a Washington state bank wants to purchase control of another state bank without actually acquiring it, it only needs to notify the director of its intent to acquire control and the date of the proposed control at least 30 days before acquisition.

b. Merger-Acquisitions and Sales of Assets and Liabilities

[2] "Reporting companies" are not limited to publicly traded entities. Any state bank or stock savings bank with more than $10 million in assets and more than 500 shareholders is a "reporting company."
[3] The Electronic Data Gathering, Analysis, and Retrieval system, available at http://www.sec.gov/edgar.shtml
[4] RCW 31.04.405.
[5] RCW 30.04.410(3).

If a state bank is merging with another state bank, the Director of Banks must approve a written application.[6] In all mergers involving a state bank or state savings bank, the Director of Banks will, as part of the Department approval process, typically require that a plan of merger similar to or more detailed than the one required by the Business Corporations Act[7] be furnished to shareholders as part of the shareholder approval process. DFI considers applications using a safety and soundness standard. In any bank acquisition, DFI must ultimately determine whether the resulting entity or entities would be unsafe or unsound, harming the public interest.

c. Federal Preemption of State Law for Changes in Control and Mergers

Documents received by the Division of Banks incident to an Application for Change in Control or Application for Merger are basically the same as the federal Notice of Change in Control. Any acquiring institution desiring confidential treatment of specific portions of its Notice of Change in Control may submit a written request with the Notice.[8] Confidential information must be specifically identified and referenced in the public portion of the application, separately bound, and labeled "Confidential." Such information is protected by federal law and exempt from disclosure.[9] Similarly, any information in an application that is supervisory or examination data is exempt from the disclosure,[10] and federal law preempts any legislation to the contrary. Finally, documents created in the examination and investigation of matters incident to a change in control or merger are specifically protected by Washington State law.[11]

---

[6] RCW 30.49.040.

[7] RCW 23B.11.030.

[8] The request must discuss the justification for the requested treatment. An acquirer's reasons for requesting confidentiality should specifically demonstrate the harm (for example, loss of competitive position, invasion of privacy) that would result from public release of the information.

[9] 5 U.S.C. §552(b) (8) and the enabling rules of the FRB, FDIC, and OCC.

[10] RCW 42.56.070(1) declares in pertinent part: "Each agency, in accordance with published rules, shall make available for public inspection and copying all public records, unless the record falls within the specific exemptions of [subsection (9)] of this section, this chapter, ***or other statute which exempts or prohibits disclosure of specific information or records***." [Emphasis added.] See *Ameriquest Mortg. Co. v. Attorney General*, 170 Wn.2d 418; 241 P.3d 1245 (2010).

[11] RCW 30.04.075; RCW 32.04.220.

III. Analysis of Proposal 2

Each of the new pieces of Proposal 2 raises separate concerns, so they will be addressed separately below. Generally, the proposal would disadvantage local banks and banks with local presences. The provisions that change confidentiality or create new public involvement in acquisitions apply only to financial institutions[12] that have offices or branches in Washington. Not only does this hurt Washington state-chartered banks by making it harder for them to contemplate mergers and acquisitions, it also has a chilling effect on the ability of weak banks to raise capital or sell themselves to other banks with a Washington presence. It would be easier and more attractive to contemplate purchases by financial institutions without any Washington affiliation. This change would disadvantage financial institutions that are already in Washington and serving its communities.

a. Public Inspection of Applications

Proposal 2 would require public inspection of any application by a financial institution with a branch or office in Washington seeking to acquire another financial institution with a branch or office in Washington. It would require information from both the acquiring and acquired institution regarding the purpose of the acquisition, and would protect supporting information obtained by DFI during the review process, while making the application itself subject to disclosure.

Currently, only two kinds of acquisition application information are protected from public disclosure: 1) information designated as "confidential" in the application (via RCW 42.56.070(1)), and 2) applications, examination reports, and supporting information for acquisitions of Washington banks by out-of-state bank holding companies (via RCW 30.04.230).

[12] "Financial institutions" is undefined, but for the purposes of this memo and based on the context of the section being amended, it is assumed to mean a bank, trust company, national banking association, or domestic bank holding company parent.

The first type of confidential information relies on federal law, and thus is not subject to change at the state level. Proposal 2's intent towards the second category is not entirely clear from the text, but it appears to remove the exemption for the acquisition application and affiliated bank examination reports while retaining the exemption for supporting information gathered by DFI during the investigation and decision-making process. It also appears to expand confidentiality to supporting information gathered while investigating an acquisition of any financial institution with a Washington presence by another financial institution with a Washington presence.

This change would likely discourage out-of-state bank holding companies from making additional purchases in Washington, as few will be interested in releasing the kind of information included in the application. This kind of information may provide a competitive advantage to its peer institutions. The application for change in control requires detailed information about the operations and status of the acquiring and acquired institutions. Institutions may be particularly uninterested in disclosing their purpose in selling or acquiring significant pieces of other institutions. As an example, if an out-of-state bank wishes to purchase 5% of a Washington bank to explore the Washington market, it may be reluctant to disclose that fact prematurely. This change would almost certainly require such disclosure. The result of this piece of the proposal would be to discourage outside investment in Washington financial institutions by exposing private businesses details, at a time when outside investment may be critical to the survival of some Washington financial institutions.

b. Public Comment on Acquisitions

Proposal 2 provides for public comments and public hearings on acquisitions of financial institutions with Washington offices or branches by other financial institutions with Washington offices or branches. DFI must disapprove of an application within 30 days (extendable to 45

days), so this requirement would significantly increase DFI's workload and may interfere with its ability to render decisions in a timely manner. It also inserts a public process into an essentially private transaction. DFI's role is not to decide whether an acquisition is a good business decision, but only to determine as a safety and soundness regulator whether very specific statutory criteria are met. There is nothing currently preventing interested parties from sending comments to DFI, and in some previous acquisitions, groups have done exactly that.

c. Public Hearings on Acquisitions

Proposal 2 would require DFI to hold public hearings on every acquisition of a financial institution with a branch or office in Washington by another financial institution with a branch or office in Washington. This part of the proposal raises the same challenges as the prior piece. DFI's role is not to decide whether an acquisition is a good business decision, but only to determine as a safety and soundness financial regulator whether specific statutory criteria are met.

d. Public Inspection of DFI's Final Determinations

Finally, Proposal 2 would require DFI to disclose all final determinations in acquisitions of financial institutions with branches or offices in Washington by other financial institutions with branches or offices in Washington. These determinations are currently confidential unless one of the institutions involved in the decision appeals the final determination.

These kinds of determinations are kept confidential in part because any unfavorable determination will likely be based on some weakness or perceived fault in the part of either the acquiring or acquired institution. A community bank whose acquisition is disapproved may be unable to find an acquiring institution regardless of the basis of the denial.

Beyond the potential harmful effect on banks and the chilling effects on mergers and acquisitions, many pieces of determinations may be subject to federal or state confidentiality, particularly when they refer to information contained in or related to bank examination reports. Even favorable decisions will almost certainly include references to information that could place the participants in an acquisition at a competitive disadvantage, and many may reference confidential supervisory information. Most of the policy purposes behind keeping examination reports confidential apply equally to this kind of determination or order.

IV. Regulatory Scope of the Amendment

Proposal 2 purports to extend far beyond DFI's authority to apply to transactions between major national banks. For example, both Citibank and U.S. Bank have offices and branches in Washington State. DFI has no authority over either of these institutions, but this amendment would seem to require DFI approval should either of these national banks try to acquire the other. DFI's authority is limited to state-chartered banks and acquisitions of state-chartered banks, and cannot be extended to regulate transactions among federally-chartered banks.

V. Conclusions

The majority of Proposal 2 would release information prepared by private enterprises engaging in merger and acquisition activity. It does so in a way that significantly disadvantages financial institutions with an existing Washington affiliation (either through a branch or office). Many parts of this proposal would negatively impact public confidence in the financial system and would discourage acquisitions activities among financial institutions with Washington branches or offices. The proposal also goes beyond the authority of the state, and purports to insert DFI and Washington State in transactions involving national or international financial institutions with minimal presences in Washington.