

OFFICE OF THRIFT SUPERVISION

Approval of an Application to Acquire a State Bank Through a Purchase and Assumption Transaction And Related Filings

Order No.: 2002-63

Date: December 12, 2002

OTS Nos. 17934, H-3827, H-3828

SBU Bank, Utica, New York, (Savings Bank) seeks approval of the Office of Thrift Supervision (OTS) pursuant to 12 U.S.C. § 1828(c) (the Bank Merger Act (BMA)), and 12 C.F.R. § 563.22 to acquire substantially all of the assets and liabilities of The Herkimer County Trust Company, Little Falls, New York (State Bank), in a purchase and assumption transaction (Purchase and Assumption). The State Bank currently conducts trust operations and the Savings Bank has applied, pursuant to 12 U.S.C. § 1464(n) and 12 C.F.R. § 550.100, to continue the existing trust operations of the State Bank. After the Purchase and Assumption, the Savings Bank would hold the State Bank as an operating subsidiary, whose sole business would be accepting municipal deposits. The State Bank would be renamed "SBU Municipal Bank" (Municipal Bank). The Savings Bank's mutual holding companies, Partners Trust Financial Group, Inc (Mid-Tier) and Partners Trust, MHC (Parent MHC) (collectively, the Applicants), have applied pursuant to 12 C.F.R. § 575.11 to conduct the municipal deposit operations in the Municipal Bank. (The foregoing are referred to as the Applications.)

The Proposed Transaction

In the proposed transaction, the Savings Bank would establish a corporate subsidiary. This subsidiary would merge with and into the State Bank's holding company, Herkimer Trust Corporation, Inc. (Target Company), with the holding company being the surviving entity. Immediately thereafter, the Target Company would dissolve. The Savings Bank and the State Bank would then engage in the Purchase and Assumption, in which the Savings Bank would acquire all of the State Bank's assets and liabilities other than those related to the State Bank's municipal deposit business. The State Bank, at that point a direct, wholly owned operating subsidiary of the Savings Bank, would be renamed as the Municipal Bank.

Adverse Comment

OTS received a comment objecting to the transaction from the Farnicola family. The comment asserted that the Savings Bank and the State Bank have stolen certain monies that had been awarded to the commenter pursuant to a personal injury lawsuit. OTS review of the commenter's assertions indicated that neither New York State nor Federal courts have granted such awards, and, in fact, because of the continued filings with these courts by the commenter, these courts have enjoined the commenter from bringing any further actions or making additional filings related to this matter without the courts' permission. Moreover, OTS found no evidence that the Savings Bank or the State Bank violated any law or regulation regarding any matters raised by the commenter's assertions.

Bank Merger Act Application

The Savings Bank seeks approval of the Purchase and Assumption under the BMA and 12 C.F.R. § 563.22. In evaluating a BMA application, OTS is required to consider the effect on the capital of the resulting association; the financial and managerial resources of the constituent institutions; the future prospects of the constituent institutions; the convenience and needs of the community; conformance to applicable law, regulation, and supervisory policy; factors relating to fairness of and disclosure concerning the transaction; and the effect on competition. Also, the USA Patriot Act amended the BMA, adding 12 U.S.C. § 1828(c)(11), which requires the responsible agency to take into consideration, in its evaluation of the BMA application, the effectiveness of any insured depository institution in combating money laundering activities. In addition, under 12 C.F.R. § 563e.29, OTS must consider the constituent institutions' records of performance under the CRA.

As for managerial resources, OTS, in its role as the regulator of the Savings Bank, is familiar with its managerial resources. Upon consummation of the acquisition of the State Bank, the board of directors and the executive officers of the Savings Bank will remain in place, and the Target Company's chairman of the board will join the Savings Bank's board. Based on its experience with the managerial resources of the Savings Bank, OTS concludes that the managerial resources of the Savings Bank are consistent with approval. The State Bank's management is regarded by its regulators as experienced and competent. Based on the foregoing, OTS concludes that the managerial resources of the Savings Bank and the State Bank are consistent with approval.

As for financial resources, and the capital level of the resulting savings association, OTS is familiar with the Savings Bank's financial resources. As of September 30, 2002, the Savings Bank's core, tangible, and risk-based capital ratios were 13.39 percent, 13.39 percent, and 25.83 percent, respectively. Upon consummation of the transaction, the Savings Bank will remain "well capitalized" pursuant to the OTS Prompt Corrective Action regulation. As of September 30, 2002, the State Bank had core

and risk-based capital ratios of 8.35 percent, and 13.01 percent, respectively. The State Bank is "well capitalized." Based on the foregoing, OTS concludes that the financial resources of the Savings Bank and the State Bank are consistent with approval, and that the level of the Savings Bank's capital is consistent with approval.

Based on its consideration of the managerial and financial resources of the Savings Bank and the State Bank, and review and evaluation of the *pro forma* financial statements for the impact of the transaction on the Savings Bank, OTS concludes that the future prospects of the Savings Bank and the State Bank are consistent with approval.

With respect to the competitive effects of the merger, OTS has reviewed the increase in the Herfindahl-Hirschman Index (HHI) and the increase in the Savings Bank's market share in the relevant geographic market that would result from the acquisition and has concluded that competitive factors considerations are consistent with approval. In the relevant geographic market of Herkimer and Oneida County, New York, the HHI will increase 230 points, to 1142, and the Savings Bank's market share, based on deposits, will increase from 16.2% to 23.3%. In addition, the Department of Justice, Antitrust Division (DOJ), closely reviewed the acquisition, and has not objected to the transaction based on competitive considerations. In addition, none of the other banking regulators objected to the transaction on competitive grounds. Based on the foregoing, OTS concludes that the competitive considerations are consistent with approval.

As for CRA, the Savings Bank's and the State Bank's most recent CRA ratings are "Satisfactory." No comments with respect to community reinvestment have been filed. Accordingly, OTS concludes that approval of the transaction is consistent with the CRA.

As for convenience and needs, the Savings Bank will be assuming the operations of the State Bank's existing offices and providing continuing services to the offices' customers and communities. Five offices of the State Bank will be closed. Two closings are considered "short-distance relocations" under relevant regulations and policies, based on the proximity of other offices of the Savings Bank. The State Bank has complied with the provisions of the branch closing provisions of the Federal Deposit Insurance Act, and contemplates that the deposits will be serviced by other branches. We are not aware of any objection to the proposed closings by members of the relevant communities. Accordingly, OTS concludes that convenience and needs considerations are consistent with approval of the transaction.

As for equitable treatment, full disclosure, employment contracts and compensation of officers and directors, the shareholders of the Target Company were provided full disclosure of the proposed transaction and voted to approve the proposed transaction. The accountholders of the State Bank will become members of the Parent MHC. Further, full disclosure has been provided regarding written or oral agreements or understandings through which any person or company will receive anything of value in connection with the proposed transaction. No officers or directors will receive

employment contracts, and the proposed compensation of the Target Company's chairman, who will join the Savings Bank's board, is within the regulatory guidelines. There will be no advisory board. Accordingly, OTS concludes that approval of the transaction is not objectionable based on equitable treatment, full disclosure, and compensation of officers and directors, and advisory boards.

As for compliance with money laundering statutes and regulations, OTS examines savings associations for compliance with such statutes and regulations. OTS has reviewed the compliance record of the Savings Bank, which involves an evaluation of the Savings Bank's compliance with anti-money laundering provisions, and concludes that the Savings Bank's effectiveness in combating money-laundering activities is consistent with approval.

Trust Application

Section 5(n) of the Home Owners' Loan Act (HOLA) authorizes OTS to grant federal savings associations the power to act as trustee, executor, administrator, guardian or in any other fiduciary capacity permitted for State banks, trust companies, or other corporations which compete with such associations in the state where the federal savings association is located.

The Savings Bank seeks approval under 12 C.F.R. Part 550 to exercise the following personal trust powers: personal trust services, such as trustee or co-trustee for living trusts, testamentary trusts, supplemental needs trusts established by court order to disburse awards to accident victims and revocable life insurance trusts; providing investment advice and exercising investment discretion as agent for funds not held in a fiduciary capacity; serving as custodian for individual retirement accounts and other individual investment vehicles; serving as trustee, custodian and investment manager for employee benefit plans; and serving as executor for estates in probate and providing estate-settlement services. The State Bank currently exercises these trust powers under its New York State charter.

Section 550.100 of the OTS regulations sets forth the factors that OTS considers in reviewing applications by federal savings associations to exercise trust powers: (1) the association's financial condition; (2) the association's capital and whether that capital is sufficient under the circumstances; (3) the association's overall performance; (4) the fiduciary powers the association proposes to exercise; (5) the association's proposed supervision of those powers; (6) the availability of legal counsel; (7) the needs of the community to be served; and (8) any other facts or circumstances that OTS considers proper.

With respect to the financial condition, capital sufficiency and overall performance of the Savings Bank, the Savings Bank will meet all regulatory capital requirements, and will be "well capitalized" under the OTS Prompt Corrective Action regulation. As required by HOLA section 5(n)(8), the Savings Bank will meet the capital

requirements applicable to New York-chartered fiduciaries. The Savings Bank has submitted financial projections for the first three years after the transaction that indicate that the Savings Bank's financial condition and capital will be sufficient to support its fiduciary operations. Accordingly, OTS concludes that the Savings Bank's financial condition, capital sufficiency and overall performance are consistent with approval.

As to the permissibility of the proposed fiduciary services to be offered, the State Bank has been conducting trust operations as a New York-chartered trust company for several years. However, we have not received a legal opinion addressing this issue, and accordingly, are imposing condition 6, set forth below.

With respect to the supervision of fiduciary activities, we have reviewed the proposed fiduciary activities and the Savings Bank's management and plans, and conclude that the Savings Bank's supervision of trust activities is consistent with approval, provided that the Savings Bank complies with condition 5, below.

With respect to the availability of experienced trust counsel, the application demonstrates that the Savings Bank will have access to competent counsel. Finally, given that the State Bank is currently providing the trust services in question to its customers, OTS concludes that there is a need in the community for the trust services.

Mutual Holding Company Considerations

Section 575.11(a) specifies that a mutual holding company (MHC) may engage in activities specified by sections 10(c)(2) or 10(c)(9)(A)(ii) of the HOLA and activities described in 12 C.F.R. § 575.10(a)(6). Section 575.10(a)(6) provides that a MHC may acquire control of, and make non-controlling investments in the stock of, any corporation other than a savings association or savings and loan holding company only if: (1) the corporation is engaged exclusively in activities permitted by section 575.11(a), or the corporation's stock would be a permissible investment for a federal savings association under 12 C.F.R. Part 559 or by a state savings association under the law of any state where the MHC's subsidiary thrift has its home office; and (2) the corporation is not controlled, directly or indirectly, by a savings association subsidiary of the MHC.

With respect to the first criterion, the Municipal Bank, which will accept deposits insured by the Federal Deposit Insurance Corporation (FDIC) from local governments and will invest in federal funds, federal agency securities and mortgage-backed securities, will engage in activities that are permissible for a subsidiary of a federal savings association.¹

With respect to the second criterion, section 575.10(a)(6)(ii) provides that corporations in which a mutual holding company invests under the authority of section

¹ See 12 C.F.R. § 559.3(e)(1) (2002). The investment would meet the operating subsidiary requirements applicable to federal associations because the Savings Bank will hold all of the Municipal Bank's stock and no other entity will have operating control of the Municipal Bank.

575.10(a)(6) must not be "controlled, directly or indirectly, by a savings association subsidiary of the mutual holding company." OTS has previously concluded that section 575.10(a)(6)(ii) prohibits a mutual holding company from directly or indirectly holding investments in subsidiaries of its savings association subsidiary other than through the savings association itself, and does not prohibit a savings association subsidiary of a MHC from having a wholly owned subsidiary. Accordingly, the Savings Bank's proposed investment in the Municipal Bank is permissible under the MHC regulations.

Recent examinations by the FDIC show the Savings Bank to be a well-capitalized and well-managed institution. OTS has reviewed the proposal and determined that the Savings Bank has the requisite experience and expertise to manage the Municipal Bank.

In addition, the Savings Bank's acquisition of the State Bank is permissible under 12 C.F.R. § 575.10, and the post-transaction treatment of depositors of the State Bank who will become depositors of the Savings Bank is consistent with 12 C.F.R. § 575.5.

For the reasons set forth above, OTS finds that the Applications satisfy the applicable approval standards, provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director, or his designee (Regional Director). Accordingly, the Applications are hereby approved, subject to the following conditions:

1. The Savings Bank and the State Bank must receive all required regulatory approvals prior to consummation of the proposed transaction with copies of all such approvals provided to the Regional Director;
2. The proposed transaction must be consummated no earlier than fifteen (15) calendar days and no later than 120 calendar days from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transaction, the chief financial officers of the Savings Bank, the Parent MHC, the Mid-Tier, the State Bank, and the Target Company must certify in writing to the Regional Director that no material adverse events or material adverse changes have occurred with respect to the financial condition or operation of the Savings Bank, the Parent MHC, the Mid-Tier, the State Bank, and the Target Company as disclosed in the Applications. If additional information having a material adverse bearing on any feature of the Applications is brought to the attention of the Savings Bank, the Parent MHC, the Mid-Tier, the State Bank, the Target Company, or OTS since the date of the financial statements submitted with the Applications, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to the consummation of the transaction;

4. The Savings Bank must advise the Regional Director in writing within five (5) calendar days after the effective date of the proposed transaction: (a) of the effective date of the proposed transaction; and (b) that the transaction was consummated in accordance with all applicable laws and regulations, the Applications and this Order;
5. Within 90 days of the consummation of the proposed transaction, the Savings Bank must ensure that an effective trust oversight program is in place, which consists of a comprehensive audit program, a compliance management program, and risk management program that addresses the considerations below:
 - a. The audit program should address auditor qualifications, audit scope and method, committee involvement, reporting, and the process for effectuating corrective action.
 - b. The compliance management program should ensure compliance with applicable laws, regulations and sound fiduciary principles. It should include, at a minimum: (a) the assignment of specific compliance responsibilities to experienced staff; (b) training for affected staff; (c) routine self-evaluations; (d) periodic compliance audits; and (e) appropriate written policies and procedures.
 - c. The risk management program should include criteria to identify, measure, monitor and control risks within fiduciary activities.
6. Within 10 days of the date of this Order, the Savings Bank's legal counsel must provide a legal opinion addressing the permissibility of the Savings Bank to conduct the proposed trust operations under New York State law; and
7. The Savings Bank must advise each accountholder whose withdrawable accounts in the resulting institution would increase above \$100,000 as a result of the proposed transaction of the effect of the transaction on insurance coverage no later than 30 calendar days after the consummation

date and shall submit evidence of such notification to the Regional Director.

Any time period specified herein may be extended by the Regional Director, for good cause, for up to 120 calendar days.

By order of the Director of the Office of Thrift Supervision, or his designee,
effective DECEMBER 12th 2002.



Richard M. Riccobono
Deputy Director