DATE: August __, 2007

MEMORANDUM TO: Board of Directors

FROM: Sandra L. Thompson
Director
Division of Supervision and Consumer Protection

Sara A. Kelsey
General Counsel

SUBJECT: **Final Rules:** Expanded Examination Cycle for Certain Small Insured Depository Institutions and U.S. Branches and Agencies of Foreign Banks

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Recommendation: Section 605 of the Financial Services Regulatory Relief Act of 2006 (FSRRA)[1] and Public Law No. 109-473[2] (collectively the "Examination Amendments") permit insured depository institutions that have up to $500 million in total assets, and that meet certain other criteria, to qualify for an 18-month (rather than the previous 12-month) on-site examination cycle.[3] On March 20, 2007, the FDIC Board of Directors approved Interim Rules to implement the Examination Amendments. The Interim Rules were jointly issued by the FDIC, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision (collectively "the Agencies") on April 10, 2007.

We recommend that the Board of Directors adopt as final the interim rules as published in April 2007.

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[1] Pub. L. 109-351, 120 Stat. 1966 (2006)
[2] 120 Stat. 3561 (2007)
[3] All the federal banking agencies supported the Examination Amendments, which allow them to better focus their supervisory resources on those institutions that may be experiencing capital, managerial, or other issues of supervisory concern, while concomitantly reducing the regulatory burden on small, well capitalized and well managed institutions.

The Interim Rules: As authorized by the Examination Amendments, the interim rules revised 12 CFR § 337.12 (Frequency of Examination) by raising, from $250 million to $500 million, the total asset threshold below which an insured depository institution may qualify for an 18-month on-site examination cycle if the institution meets the other qualifying criteria set forth in section 10(d) of the Federal Deposit Insurance Act and in the Agencies' rules. In addition, the Agencies determined that it is consistent with safety and soundness to permit institutions with between $250 million and $500 million in total assets that received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (commonly referred to as CAMELS[4]), and that meet the other qualifying criteria set forth in section 10(d) and the Agencies' rules, to qualify for an 18-month examination cycle. In addition, the revisions to section 337.12 clarified, consistent with current practice, that a small institution meets the statutory "well managed" criteria for an 18-month cycle if the institution, besides having a CAMELS composite rating of 1 or 2, also received a rating of 1 or 2 for the management component of the CAMELS rating at its most recent examination.

The interim rules also revised 12 CFR § 347.211 (Examination of offices and affiliates of foreign banks) to implement the changes to the examination frequency as allowed by section 7(c)(1)(C) of the IBA with respect to on-site examination cycles for the U.S. branches and agencies of foreign banks. Thus, a foreign bank office with total

[4] CAMELS is an acronym that is drawn from the first letters of the individual components of the rating system: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk.

assets less than $500 million may qualify for an 18-month exam cycle if the office received a composite ROCA[5] rating of 1 or 2 at its most recent examination.

Section 10(d) of the FDI Act and section 7(c)(1)(C) of the IBA set the outside parameters for conducting on-site safety and soundness examinations of an institution or foreign bank office. These statutes permit the appropriate federal banking agency for an institution or foreign bank office to conduct an on-site examination more frequently than required, and the Agencies' rules continue to expressly recognize that the appropriate Agency may examine an institution or foreign bank office as frequently as the Agency deems necessary.

The Agencies received comments on the interim rules from 11 commenters, which included six banking trade associations, four insured depository institutions, and one law firm. All commenters supported the interim rules and generally agreed that the rules would appropriately reduce regulatory burden for qualifying small institutions and foreign offices without creating undue risk to the institutions, officers or the deposit insurance fund.

As with the interim rules, the Agencies estimate that the final rules will increase the number of potentially eligible insured depository institutions for an 18-month examination cycle by approximately 1,089 and foreign bank offices by 31.

Based on a review of the comments and the reasons set forth in this memorandum, we recommend that the Board adopt as final the interim rules as published in April 2007 without change.

[5] The four components of the ROCA supervisory rating system for foreign bank offices are: Risk management, Operational controls, Compliance, and Asset quality.

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Attachments