

August 16, 2018

TO: The Board of Directors

FROM: Doreen R. Eberley
Director, Division of Risk Management Supervision

SUBJECT: *Interim final rule:* Expanded Exam Cycle for Certain Small Insured Depository Institutions and U.S. Branches and Agencies of Foreign Banks

Summary: The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System (FRB), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies), jointly are amending their regulations with regard to the examination cycle for certain small insured depository institutions (IDIs) consistent with amendments to section 10(d) of the Federal Deposit Insurance Act (FDI Act) made by section 210 of the Economic Growth Regulatory Relief and Consumer Protection Act (Act). Section 210 of the Act permits IDIs that have total assets of less than \$3 billion (from the previous \$1 billion), and that meet certain other criteria, to qualify for an 18-month, on-site examination cycle. The interim final rule amends 12 CFR 337.12, *Frequency of Examination* and 12 CFR 347.211, *Examination of Branches of Foreign Banks*, to permit institutions that have total assets of less than \$3 billion (rather than the previous \$1 billion) that received a composite rating of outstanding or good at the most recent examination, and meet certain other criteria, to qualify for an 18-month on-site examination cycle.

Staff recommends that the Board of Directors (Board) find that good cause exists to publish this rule as final with an immediate effective date, because this rule implements the provisions of section 210 of the Act, which became effective on May 24, 2018.

Recommendation: That the Board adopts and issues the attached interim final rule as indicated and authorize its publication in the *Federal Register*.

Concur:

Charles Y1
General Counsel

Background

Section 10(d) of the FDI Act¹ generally requires that the appropriate Federal banking agency for an IDI conduct a full scope, on-site examination of the institution at least once during each 12-month period. Prior to the enactment of section 210 of the Act, section 10(d) authorized the appropriate Federal banking agency to extend the on-site examination cycle for an IDI to at least once during an 18-month period if the institution (1) had total assets of less than \$1 billion; (2) was well capitalized (as defined in the prompt corrective action provisions in 12 U.S.C. 1831o); (3) was found, at its most recent examination, to be well managed and to have a CAMELS² composite condition of outstanding or good³; (4) was not subject to a formal enforcement proceeding or order by the FDIC or its appropriate Federal banking agency; and (5) had not undergone a change in control during the previous 12-month period in which a full-scope, on-site examination otherwise would have been required. The agencies previously adopted regulations to implement the examination cycle requirements of section 10(d) of the FDI Act and section 7(c)(1)(C) of the International Banking Act (IBA),⁴ including the extended 18-month examination cycle available to qualifying small institutions and foreign bank offices.⁵ Prior to the enactment of the Act, a small IDI had to have total assets of less than \$1 billion in order to be eligible for the 18-month extended examination cycle.

The FDIC and FRB, as the appropriate Federal banking agencies for state-chartered insured banks and savings associations, are permitted to conduct on-site examinations of such institutions on alternating 12-month or 18-month periods with the institution's State banking supervisor, if the FDIC and the FRB, as appropriate, determine that the alternating examination conducted by the State banking supervisor is consistent with section 10(d) of the FDI Act. In addition, section 7(c)(1)(C) of the IBA provides that a Federal and a State branch or

¹ Section 10(d) of the FDI Act was added by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) and is codified at 12 U.S.C. 1820(d).

² CAMELS is an acronym drawn from the first letters of the individual components of the Uniform Financial Institutions Rating System: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk.

³ Under section 10(d) of the FDI Act, before enactment of the Act, the agencies had the authority to extend the 18-month examination cycle to institutions with composite CAMELS ratings of 2 and assets up to \$1 billion. Section 10(d) required that the agencies determine that extending the 18-month cycle in this manner would be consistent with safety and soundness.

⁴ 12 U.S.C. 3105(c)(1)(C).

⁵ See 12 CFR 337.12 and 347.211 (FDIC); 12 CFR 208.64 and 211.26 (FRB); and 12 CFR 4.6 and 4.7 (OCC).

agency of a foreign bank shall be subject to on-site examination by its appropriate Federal banking agency or State banking supervisor as frequently as a national or state bank would be subject to such an examination by the agency.⁶

Section 210 of the Act amends section 10(d)(4) of the FDI Act to raise, from \$1 billion to \$3 billion, the total asset threshold below which the agencies may apply an 18-month (rather than a 12-month) on-site examination cycle for qualifying IDIs with “outstanding” composite ratings. Section 210 of the Act also amended section 10(d)(10) of the FDI Act to authorize the appropriate Federal banking agency to increase, by regulation, the total asset maximum limitation for applying the 18-month examination cycle to an amount not to exceed \$3 billion for qualifying IDIs with “outstanding” or “good” composite ratings, if the agency determines that the greater amount would be consistent with the principles of safety and soundness.⁷

These amendments reduce regulatory burden on small, well-capitalized, and well-managed institutions and allow the agencies to better focus their supervisory resources on those IDIs and U.S. branches and agencies of foreign banks that may present capital, managerial, or other issues of supervisory concern. The agencies will continue to use off-site monitoring tools to identify potential problems in small, well-capitalized, and well-managed institutions. Moreover, the statute does not limit the authority of the agencies, to examine an IDI or U.S. branch or agency of a foreign bank more frequently than would be required by the FDI Act or the IBA.⁸

Description of the Interim Final Rule

The agencies are adopting the interim final rule to implement the recent amendments to section 10(d) of the FDI Act. Consistent with section 7(c)(1)(C) of the IBA, the agencies also are making conforming changes to their regulations governing the on-site examination cycle for the U.S. branches and agencies of foreign banks. In particular, the agencies are amending their respective rules to raise, from \$1 billion to \$3 billion, the total asset threshold below which an IDI that has “outstanding” composite ratings and that meets the criteria in section 10(d) of the FDI Act and the agencies’ rules may qualify for an 18-month, on-site examination cycle. In addition, as

⁶ 12 U.S.C. 3105(c).

⁷ 12 USC 1820(d)(10), 1820(d)(4)(c)(ii).

⁸ See 12 CFR 337.12(c) and 12 CFR 347.211(c) (FDIC); 12 CFR 208.64(c) and 211.26(c)(3) (FRB); and 12 CFR 4.6(c) and 4.7(c) (OCC).

authorized by section 210 of the Act, the agencies have determined that it is consistent with safety and soundness principles to permit IDIs with total assets from \$200 million and less than \$3 billion that received a composite CAMELS rating of “1” or “2,” 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 accordance with section 7(c)(1)(C) of the IBA, the agencies are also amending their regulations governing U.S. branches and agencies of foreign banks that received a Risk management, Operational controls, Compliance, and Asset quality system (ROCA) rating of “1” or “2,”⁹ 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.

Expected Effects of the Interim Final Rule

The agencies estimate that the interim final rule will increase the number of institutions that may qualify for an extended 18-month examination cycle by approximately 420 institutions (227 of which are supervised by the FDIC, 100 by the OCC, and 93 by the FRB), bringing the total number to 4,798 IDIs.¹⁰ Approximately 33 foreign branches and agencies would be eligible for the extended examination cycle based on the interim final rule (2 supervised by the FDIC, 22 by the Board, and 9 by the OCC).

The agencies have off-site monitoring activities and the ability to examine an institution more frequently as necessary or appropriate. Therefore, the change in the examination cycle should not negatively affect the safe and sound operations of qualifying institutions or the ability of the agencies to effectively supervise and protect the safety and soundness of institutions with total assets of less than \$3 billion. Furthermore, the agencies note that, in order to qualify for an 18-month examination cycle, any institution with total assets of less than \$3 billion must meet the other capital, managerial and supervisory criteria set forth in section 10(d) of the FDI Act. The agencies will continue to monitor institutions in this asset range to measure the impact of the extended examination cycle.

⁹ For U.S. branches and agencies of foreign banks, the composite ROCA rating is comparable to the CAMELS rating.

¹⁰ Call report data, Mar. 31, 2018.

Effective Date/Request for Comment

The agencies are issuing the interim final rule without prior notice and the opportunity for public comment and the 30-day delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA).¹¹ Pursuant to section 553(b)(B) of the APA, general notice and the opportunity for public comment are not required with respect to a rulemaking when an “agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rule issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.” The interim final rule implements the provisions of section 210 of the Act, which became effective on May 24, 2018. The interim final rule adopts without change the statutory increase in the total asset ceiling for the 18-month examination cycle for eligible CAMELS and ROCA 1-rated institutions and also makes available, pursuant to statutory authority, the 18-month examination cycle for eligible CAMELS and ROCA 2-rated institutions. Consistent with the underlying statute, the interim final rule will allow well-capitalized and well-managed institutions with total asset of less than \$3 billion that meet the other capital, managerial and supervisory criteria set forth in section 10(d) of the FDI Act to benefit from the statutorily extended 18-month examination schedule.

The agencies believe that the public interest is best served by implementing the statutorily amended thresholds for examination purposes as soon as possible. Immediate implementation would reduce regulatory burden on small, well-capitalized, and well-managed institutions, while also allowing the agencies to better focus their supervisory resources on those institutions that may present capital, managerial, or other issues of supervisory concern. Because the affected institutions and agencies must plan and prepare for examinations in advance, the agencies believe issuing interim final rule will provide the certainty necessary to allow the institutions and agencies to begin scheduling according to the new examination cycle period. In addition, the agencies believe that providing a notice and comment period prior to issuance of the interim final rule is

¹¹ 5 U.S.C. 553.

unnecessary because the agencies do not expect the public to object to the regulations being promulgated, as this rule implements changes specified by Congress.¹²

The APA also requires a 30-day delayed effective date, except for (1) substantive rules which grant or recognize an exemption or relieve a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause.¹³ The agencies conclude that, because the rule recognizes an exemption, the interim rule is exempt from the APA's delayed effective date requirement.¹⁴ Additionally, the agencies find good cause to publish the interim final rule with an immediate effective date for the same reasons set forth above under the discussion of section 553(b)(B) of the APA.

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),¹⁵ in determining the effective date and administrative compliance requirements for a new regulation that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider any administrative burden that such regulation would place on depository institutions and the benefit of such regulation. In addition, section 302(b) of the RCDRIA requires such new regulation to take effect on the first day of a calendar quarter which begins on or after the date on which the regulation is published in final form, with certain exceptions, including for good cause. Because the interim final rule expands eligibility for an 18-month, rather than 12-month on-site examination schedule, and is burden-reducing in nature, the interim final rule does not impose additional reporting, disclosure, or other requirements on insured depository institutions, and section 302 of the RCDRIA, therefore, does not apply. Nevertheless, the agencies have considered the administrative burden that such regulations would place on depository institutions and the benefit of such regulations in determining the effective date and compliance requirements as discussed above and below. For the same reasons set forth above under the discussion of section 553(b)(B) of the APA, the agencies find good cause to publish the interim final rule with an immediate effective date.

¹² See 81 FR 90949 (Dec. 16, 2016).

¹³ 5 U.S.C. 553(d).

¹⁴ 5 U.S.C. 553(d)(1).

¹⁵ 12 U.S.C. 4802(a).

While the agencies believe good cause exists to issue the interim final rule without advance notice and comment and with an immediate effective date, the agencies are interested in the views of the public and request comment on all aspects of the interim final rule.

Conclusion

FDIC staff recommends that the Board adopt the attached interim final rule with an immediate effective date and authorize publication in the *Federal Register* for a 60-day comment period.

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