December 3, 2018

TO: The Board of Directors

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

SUBJECT: ***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) are finalizing without change the interim final rule published in the *Federal Register* on August 29, 2018, which amended 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 amended 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.

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

Concur:

Charles Yi, General Counsel

Background

Section 10(d) of the FDI Act[1] 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 CAMELS[2] composite condition of outstanding or good;[3] (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 Federal and State branches or agencies of foreign banks shall be subject to on-site examination by the 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.

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[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).

[6] 12 U.S.C. 3105(c).

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 Final Rule

The agencies adopted the interim final rule to implement the amendments to section 10(d) of the FDI Act. Consistent with section 7(c)(1)(C) of the IBA, the agencies also made 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 amended 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 authorized by section 210 of the Act, the agencies 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 also amended 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.

Three comments were received on the interim final rule, two from trade associations and one from a multibank holding company with subsidiary banks that would be affected by the interim final rule. All three comments were supportive. The final rule adopts the interim final rule without change.

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[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).

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

Expected Effects of the Final Rule

Based on data available at publication, the agencies estimate that the number of banks and savings associations that may qualify for an extended 18-month examination cycle increased by approximately 430 (241 of which are supervised by the FDIC, 99 by the OCC, and 90 by the Board), bringing the total number to 4,706 banks and savings associations since the issuance of the interim final rules.[10] Approximately 30 U.S. branches and agencies of foreign banks would be eligible for the extended examination cycle based on the final rules (2 of which are supervised by the FDIC, 8 by the OCC, and 20 by the FRB).[11]

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.

Effective Date

The Administrative Procedure Act (APA) generally requires that a final rule be published in the *Federal Register* no less than 30 days before its effective date. The interim final rules will continue to be in effect until the final rules become effective.

Conclusion

FDIC staff recommends that the Board adopt the attached final rule and authorize publication in the *Federal Register*.

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[10] Call Report data, Sept. 30, 2018.

[11] *Id.*