

October 20, 2020

**MEMORANDUM TO:** Board of Directors

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

**SUBJECT:** Interim Final Rule - Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021

**Summary of Recommendation**

Staff recommends that the FDIC's Board of Directors approve and authorize for publication in the Federal Register with a thirty-day public comment period the attached Interim Final Rule (IFR) and Request for Comment, entitled *Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021*. In response to disruptions in economic conditions and strains on the financial markets caused by the coronavirus disease 2019 (COVID-19), the IFR would allow insured depository institutions (IDIs) to temporarily freeze consolidated total assets as of December 31, 2019, for the purpose of determining compliance with the audit and reporting requirements of 12 CFR Part 363 (Part 363) for fiscal years ending in 2021. The IFR will provide regulatory relief for institutions that have increased in total consolidated asset size above the applicable Part 363 thresholds since December 31, 2019 due to their participation in COVID-19 related economic stimulus programs. IDIs whose consolidated total assets have decreased will use the IDI's consolidated total assets as of the first day of its fiscal year ending in 2021.

**SUPPLEMENTARY INFORMATION:**

**Background**

Section 36 of the Federal Deposit Insurance Act, 12 U.S.C. 1831m, (section 36) was added by the Federal Deposit Insurance Corporation Improvement Act of 1991 and imposes annual audit and reporting requirements on IDIs that meet certain asset thresholds. The purpose of section 36 is to facilitate early identification of needed improvements in financial management at IDIs. Section 36 grants the FDIC discretion to set the asset size threshold for compliance with these statutory requirements, but mandates a minimum threshold of \$150 million in consolidated total assets. Part 363 of the FDIC's regulations implements section 36. Currently, an IDI becomes subject to the annual independent audit and reporting requirements of Part 363 with respect to any fiscal year in which its consolidated total assets, as of the beginning of such year, are \$500

**CONCUR:**

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million or more.<sup>1</sup> Additionally, an IDI with consolidated total assets of \$1 billion or more as of the beginning of any fiscal year must provide management's assessment of, and the independent public accountant's report on, the effectiveness of internal control over financial reporting.<sup>2</sup>

Part 363 thresholds also include requirements related to audit committees. Each IDI with consolidated total assets of \$500 million or more but less than \$1 billion at the beginning of its fiscal year must establish an independent audit committee of its board of directors, the members of which must be outside directors, the majority of whom are independent of management of the IDI.<sup>3</sup> Each IDI with consolidated total assets of \$1 billion or more at the beginning of its fiscal year must establish an independent audit committee of its board of directors, the members of which must be outside directors who are independent of management of the IDI.<sup>4</sup> IDIs with consolidated total assets of \$3 billion or more as of the beginning of their fiscal year are required to include members with banking or related financial management expertise on audit committees, provide the audit committee with access to its own outside counsel, and not include members who are large customers of the institution.<sup>5</sup>

As a result of the impact that COVID-19 has had on the financial markets and the economy, Congress and federal agencies have launched a variety of programs to stabilize the financial system and provide relief to households and businesses. Such programs include (i) the Money Market Mutual Fund Liquidity Facility (MMLF), through which the Federal Reserve Bank of Boston makes loans available to eligible financial institutions secured by high-quality assets purchased by the financial institution from money market mutual funds; (ii) the Paycheck Protection Program (PPP), a program which Congress established as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to facilitate loans to small businesses that may be forgiven if used to fund payroll and other eligible expenses; and (iii) the Paycheck Protection Program Liquidity Facility Fund (PPPLF), which extends credit to eligible financial institutions that originate PPP loans, taking the loans as collateral.

Participation in the MMLF, PPP, and PPPLF has ensured that IDIs remain able to serve as financial intermediaries and accommodate customer needs, while simultaneously providing needed economic stability. However, such participation and the effects of other stimulus programs have caused certain IDIs to experience a temporary *increase* in their consolidated total assets and thus become subject to the annual independent audit and reporting requirements of Part 363. While some of these IDIs may have reached these thresholds through organic growth or other means, it is likely that others may not have reached the threshold but for the effects of these government programs and other types of stimulus. Absent the regulatory relief afforded in the IFR, these IDIs will be forced to incur additional compliance and related regulatory expenses. These expenses include engaging independent auditors, performing assessments of internal control over financial reporting, reviewing and filing reports, and modifying the makeup of their boards of directors in order to comply with the requirements of Part 363.

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<sup>1</sup> 12 C.F.R. § 363.1(a).

<sup>2</sup> 12 C.F.R. § 363.2(b)(3) and § 363.3(b).

<sup>3</sup> 12 C.F.R. § 363.5(a)(2).

<sup>4</sup> 12 C.F.R. § 363.5(a)(1).

<sup>5</sup> 12 C.F.R. § 363.5(b).

## **The Interim Final Rule**

The IFR would provide temporary regulatory relief to negate the cost and burden effects of potentially temporary asset growth associated with pandemic-related programs and similar impacts. The IFR accomplishes this by allowing IDIs to temporarily freeze consolidated total assets as of December 31, 2019, for the purpose of determining whether the IDI is subject to the requirements of Part 363 for fiscal years ending in 2021, instead of the IDI's actual date of its 2020 fiscal year-end. For example, an IDI with a fiscal year beginning July 1, 2020, and ending June 30, 2021, would normally determine its Part 363 compliance requirements as of the previous fiscal year end (June 30, 2020), but the IFR would direct the IDI to use its consolidated total assets as of December 31, 2019, for purposes of complying with Part 363 for its fiscal year beginning July 1, 2020. In this example, if the IDI's consolidated total assets were less than \$500 million as of December 31, 2019, it would not become subject to Part 363 for its fiscal year beginning July 1, 2020, and ending June 30, 2021, even if its total consolidated total assets were \$500 million or more as of June 30, 2020.

Based on consolidated total assets as of December 31, 2019, and June 30, 2020, this proposal would potentially apply to approximately 290 IDIs including:

- 156 IDIs based on the number of IDIs that had consolidated total assets of \$500 million or more as of December 31, 2019, compared to the number of IDIs that had consolidated total assets of \$500 million or more as of June 30, 2020;
- 107 IDIs based on the number of IDIs that had consolidated total assets of \$1 billion or more as of December 31, 2019, compared to the number of IDIs that had consolidated total assets of \$1 billion or more as of June 30, 2020; and
- 27 IDIs based on the number of IDIs that had consolidated total assets of \$3 billion or more as of December 31, 2019, compared to the number of IDIs that had consolidated total assets of \$3 billion or more as of June 30, 2020.

Notwithstanding any temporary relief provided by this IFR, an IDI would continue to be subject to any otherwise applicable statutory and regulatory audit and reporting requirements.

Staff recommends issuing this relief as an interim final rule with immediate effect, as there is good cause to do so. The public interest is best served by mitigating the compliance burden and audit-related expenses that these IDIs would otherwise incur primarily as a result of participating in these crucial government programs that have stabilized the economy and calmed disruption in the financial markets. The IFR also reserves the authority to require an IDI to comply with one or more requirements if the FDIC determines that asset growth was related to a merger or acquisition. While the IFR would take effect immediately, the public will be asked to comment on all aspects of the rule.

## **Recommendation**

Staff recommends that the Board approve the attached Resolution to authorize publication of the IFR entitled *Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021* in the Federal Register.

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