

DATE: January 20, 2016

TO: The Board of Directors

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

SUBJECT: ***Interim final rules with request for comments.*** 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 consistent with amendments to section 10(d) of the Federal Deposit Insurance Act (FDI Act) made by section 83001 of the Fixing America's Surface Transportation Act, P.L. 114-94 (FAST Act). The FAST Act permits insured depository institutions that have up to \$1 billion (from the previous \$500 million) in total assets, and that meet certain other criteria, to qualify for an 18-month, on-site examination cycle. The interim final rules amend 12 CFR section 337.12, *Frequency of Examination* and 12 CFR section 347.211, *Examination of Branches of Foreign Banks*, to permit institutions with up to \$1 billion (rather than the previous \$500 million) in total assets 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.

Additionally, to streamline the FDIC's regulations, staff recommends rescinding and removing a transferred Office of Thrift Supervision regulation, 12 CFR section 390.351, *Frequency of Safety and Soundness Examination*. This section contains provisions that are substantially similar to 12 CFR section 337.12, and the interim final rule will consolidate regulations relating to both insured State nonmember banks and State savings associations.

Staff recommends that the Board of Directors (Board) find that good cause exists to publish this rule as final and with an immediate effective date because this rule implements, without change, the provisions of section 83001 of the FAST Act, which became effective on December 4, 2015. The interim final rules would allow well capitalized and well managed institutions to benefit from the extended 18-month examination schedule.

Recommendation: That the Board adopt and issue the attached interim final rules as indicated and authorize publication in the *Federal Register*.

Concur:



Charles Yi
General Counsel

Discussion

Background

Section 10(d) of the FDI Act¹ generally requires that the appropriate Federal banking agency for an insured depository institution conduct a full scope, on-site examination of the institution at least once during each 12- month period. Prior to enactment of the FAST Act, section 10(d) also authorized the appropriate Federal banking agency to extend the on-site examination cycle for an insured depository institution to at least once during an 18 month period if the institution (1) had total assets of less than \$500 million; (2) was well capitalized (as defined in prompt corrective action 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), including the extended 18-month examination cycle available to qualifying small institutions and foreign bank offices. Prior to the enactment of the FAST Act, a qualifying small insured depository institution was one holding total assets of less than \$500 million.

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, Earnings, Management, Liquidity, and Sensitivity to market risk.

³ Under section 10(d) of the FDI Act, before enactment of the FAST 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 \$500 million. Section 10(d) required that the Agencies determine that extending the 18-month cycle in this manner would be consistent with safety and soundness. (See 62 FR 6449, February 12, 1997 (interim rule); see also 63 FR 16377, April 2, 1998 (final rule); see also 72 FR 17798, April 10, 2007 (interim rule); see also 72 FR 54347 September 25, 2007 (final rule).

The FRB and the FDIC as the appropriate Federal banking agencies for state-chartered insured banks and state-chartered 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 supervisor, if the FRB and the FDIC, as appropriate, determines that the alternating examination conducted by the State carries out the purposes of 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 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.⁴

Section 83001 of the FAST Act, effective on December 4, 2015, amended section 10(d) of the FDI Act to raise, from \$500 million to \$1 billion, the total asset threshold below which an insured depository institution may qualify for an 18-month on-site examination cycle and to raise from not more than \$100 million to not more than \$200 million, the total asset threshold below which an insured depository institution with an outstanding or good composite condition may qualify for an 18-month on-site examination cycle. Section 83001 also amended section 10(d)(10) of the FDI Act to authorize the appropriate Federal banking agency to increase, by regulation, the maximum amount limitation from not more than \$200 million to an amount not to exceed \$1 billion, if the agency determines that the greater amount would be consistent with the principles of safety and soundness for insured depository institutions. This provision would

⁴ 12 U.S.C. 3501(c).

permit the agencies to make a finding about safety and soundness for institutions rated good with total assets between \$200 million and \$1 billion.⁵

These FAST Act amendments reduce regulatory burdens on small, well capitalized, and well managed institutions and allow the agencies to better focus their supervisory resources on those insured depository institutions 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 smaller, well capitalized, and well managed institutions. Moreover, the statute does not limit the ability of the agencies, and the agencies' regulations reserve the right, 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.

Description of the Interim Final Rules

The agencies are adopting interim final rules 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 \$500 million to \$1 billion, the total asset threshold below which an institution that meets both the qualifying criteria in section 10(d) and the agencies' rules may qualify for an 18-month, on-site examination cycle. In addition, as authorized by the FAST Act, the agencies have determined that it is consistent with safety and soundness principles to permit institutions with total assets from \$200 million and not exceeding \$1 billion that received a composite CAMELS, rating of "1" or "2," or, for foreign branches, a Risk management,

⁵ Public Law No. 109-47, which became effective on January 11, 2007, also amended section 10(d)(10) of the FDI Act to authorize the appropriate agency, if it determines the action would be consistent with principles of safety and soundness, to allow an insured depository institution that falls within this expanded total asset threshold to qualify for an 18-month examination cycle if the institution received a composite rating of outstanding or good at its most recent examination

Operational controls, Compliance, and Asset quality system (ROCA) of “1” or “2”⁶ 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. FDIC staff analyzed the frequency with which institutions rated a composite CAMELS rating of “1” or “2” failed within five years versus the failure rate for institutions rated “3,” “4,” or “5” during the same period. FDIC analysis indicates that between 1985 and 2010 (using bank failure data through 2015) FDIC-insured depository institutions with assets less than \$1 billion and a composite CAMELS rating of “1” or “2” had a five-year failure rate that was one-seventh as high as institutions with a CAMELS rating of “3,” “4,” or “5.” Moreover, the relationship between failure rates in the two ratings groups does not meaningfully change when the analysis is restricted to institutions with assets between \$200 million and \$500 million compared to institutions with assets between \$500 million to \$1 billion. This suggests that extending the examination cycle for well-rated institutions with \$500 million to \$1 billion in assets by an additional six months combined with the agencies’ off-site monitoring activities and ability to examine an institution more frequently as necessary or appropriate, will 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 \$1 billion.

The agencies estimate that these interim final rules will increase the number of institutions that may qualify for an extended 18-month examination cycle by approximately 617 institutions (371 of which are supervised by the FDIC, 142 by the OCC, and 104 by the FRB), bringing the total number to 4,987 insured depository institutions. Approximately 89 foreign branches and agencies would be eligible for the extended examination cycle based on the interim

⁶ For U.S. branches and agencies of foreign banks, the composite ROCA rating is comparable to the CAMELS rating.

final rules, for an increase of 26 offices. (1 of which is supervised by the FDIC, 3 by the OCC, and 22 by the FRB).

Consistent Treatment for Insured State Savings Associations Regarding Examination Frequency

An Office of Thrift Supervision (OTS) rule transferred to the FDIC governs the frequency of safety and soundness examinations of State savings associations. The OTS rule, formerly found at 12 CFR section 563.171, was transferred to the FDIC with nominal change and is now found in 12 CFR 390.351 of the FDIC rules and regulations. The FDIC's rule contained in 12 CFR 337.12 governs the frequency of safety and soundness examinations for State nonmember banks. After careful review and comparison of section 390.351 and section 337.12, the staff has determined that the rules are substantively identical. Therefore, the interim final rules rescind section 390.351 and amends section 337.12 to apply its requirements to all FDIC-supervised institutions, including State savings associations.

Effective Date/Request for Comments

The agencies are issuing the interim final rules without prior notice and the opportunity for public comment and the 30-day delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA).⁷ 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 rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.” The interim final rules implement the provisions of section 83001 of the FAST Act, which became effective on December 4, 2015. The interim final rules adopt without change the statutory increase in the total asset ceiling for the 18-month examination cycle for CAMELS and ROCA 1-rated institutions and also make available

⁷ 5 U.S.C. 553.

pursuant to statutory authority, the 18-month examination cycle for CAMELS and ROCA 2-rated institutions. Consistent with the underlying statute, the interim final rules would allow well capitalized and well managed institutions with under \$1 billion in total assets 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 as soon as possible. Immediate implementation would reduce regulatory burdens 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 rules would 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 rules is unnecessary because the agencies do not expect public objection to the regulations being promulgated, as these rules implement the changes specified by Congress.⁸

Similarly, the FDIC believes there is good cause to rescind and remove section 390.351 because section 337.12 will be made immediately applicable to both insured State savings associations and insured State nonmember banks. As a result, insured State savings associations will be provided the same burden reduction benefits and appropriate supervisory focus afforded

⁸ All eleven commenters supported the agencies' 2007 interim final rules implementing section 605 of the Financial Services Regulatory Relief Act of 2006 (FSRRA), which revised section 10(d) to allow institutions with up to \$500 million in total assets to qualify for an 18-month on-site examination cycle. Prior to the enactment of FSRRA, only institutions with less than \$250 million were eligible for an 18-month on-site examination cycle. See 72 FR 54347 (Sept. 25, 2007) (final rule); see also, 72 FR 17798 (Apr. 10, 2007) (interim rule).

to insured State nonmember banks. For these reasons, the agencies find there is good cause consistent with the public interest to issue the rules without advance notice and comment.⁹

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.¹⁰ The agencies conclude that, because the rules recognize an exemption, the interim final rules are exempt from the APA's delayed effective date requirement.¹¹ Additionally, the agencies find good cause to publish the interim final rules 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),¹² in determining the effective date and administrative compliance requirements for a new regulation that imposes additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider any administrative burdens that such regulation would place on depository institutions and the benefits 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 that begins on or after the date on which the regulations are published in final form, with certain exceptions, including for good cause. Because the interim final rules expand eligibility for an 18-month, rather than 12-month on-site examination schedule and are burden-reducing in nature, the interim final rules do not impose additional reporting, disclosure, or other requirements on insured depository institutions, and section 302 of the RCDRI Act therefore does not apply. Nevertheless, the agencies have

⁹ 5 U.S.C. 553(b)(3)(A)-(B); 553(d)(3).

¹⁰ 5 U.S.C. 553(d).

¹¹ 5 U.S.C. 553(d)(1).

¹² 12 U.S.C. 4802(a).

considered the administrative burdens that such regulations would place on depository institutions and the benefits of such regulations in determining the effective date and compliance requirements. For the same reasons set forth above under the discussion of section 553(b)(B) of the APA, the agencies find good cause would exist under section 302 of the RCDRIA to publish these interim final rules with an immediate effective date.

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

Conclusion

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

Staff Contacts:

RMS

Karen Currie ext. 8-3981
Timothy Millette ext. 8-6827

Legal

Mark Mellon ext. 8-6858
Rodney Ray ext. 8-3556
Sue Dawley ext. 8-6509