

**DEPARTMENT OF THE TREASURY**  
**Office of the Comptroller of the Currency**

**12 CFR Part 4**

**[Docket No. 97-02]**

**RIN 1557-AB56**

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 208**

**[Regulation H; Docket No. R-09571]**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**12 CFR Part 337**

**RIN 3064-AB90**

**DEPARTMENT OF THE TREASURY**

**Office of Thrift Supervision**

**12 CFR Part 563**

**[Docket No. 97- ]**

**RIN 1550-AB02**

**Expanded Examination Cycle For Certain**

**Small Insured Institutions**

AGENCIES: Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and **Office** of Thrift Supervision.

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System (Board), the **Office** of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the Agencies) are adopting as a final rule their joint interim rule implementing section 306 of the Riegle Community Development and Regulatory Improvement Act of 1994 (**CDRI**) and section 2221 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). Together, section 306 of **CDRI** and section 2221 of EGRPRA authorize the Agencies to increase the asset size of certain financial institutions that may be examined once in every **18-month** period, rather than once in every 12-month period, from \$100 million to a revised limit of \$250 million. This **final** rule makes certain institutions that have \$250 million or less in assets eligible for the 18-month examination schedule.

EFFECTIVE DATE: [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]

FOR FURTHER INFORMATION CONTACT:

**OCC:** Lawrence W. Morris, National Bank Examiner, Examination Process (202) 874-4915; Ronald Schneck, Director, Special Supervision, (202) **874-4450**; or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities, (202) 874-5090.

**Board:** Molly Wassom, Deputy Associate Director, (202) **452-2305**, or William H. **Tiernay**, Senior Financial Analyst, (202) 872-7579, Division of Banking Supervision and

Regulation. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Diane Jenkins (202) 452-3544.

**FDIC:** Mark A. Mellon. Counsel. Regulation and Legislation section (202) 898-3854, Legal Division, or Robert W. Walsh, Manager, Planning and Program Development section (202) 898-6911, Division of Supervision, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

**OTS:** Scott M. Albinson. Special Assistant to the Executive Director, Supervision, (202) 906-7984; or Ellen J. Sazzman. Counsel (Banking and Finance), Regulations and Legislation Division, Office of the Chief Counsel, (202) 906-7133.

#### SUPPLEMENTARY INFORMATION:

##### **Background**

Section 10(d) of the Federal Deposit Insurance Act (the FDI Act),<sup>1</sup> which was added by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA),<sup>2</sup> requires that each appropriate Federal banking agency conduct a full-scope, on-site examination at least once during each 12-month period of every insured depository institution that the agency supervises. However, section 10(d) permits the Agencies to examine certain small insured depository institutions once during every **18-month** period. As initially established by FDICIA, section 10(d) required an institution to have \$100 million or less in total assets and its composite condition must have been found to be outstanding (rated 1 under

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<sup>1</sup> Section 10(d) of the FDI Act is codified at 12 U.S.C. 1820(d).

<sup>2</sup> Pub. L. 102-242, 105 Stat. 2236.

the Uniform Financial Institutions Rating System (UFIRS)) at its most recent examination in order to qualify for an extended exam cycle. In addition, a qualifying institution (a) must not have undergone a change in control during the previous 12-month period in which a full-scope examination otherwise would have been required by section 10 of the FDI Act; (b) be well capitalized; and (c) be found by the appropriate agency to be well managed.

Section 306 of CDRI, which was enacted into law in 1994,<sup>3</sup> made several amendments to section 10(d) that, taken together, expand the availability of the 18-month examination cycle to a larger number of small institutions. First, section 306 of **CDRI** increased to \$250 million the asset size of institutions rated outstanding (UFIRS 1) that could be examined on an 18-month cycle. Second, section 306 added a provision permitting an 18-month cycle for institutions rated satisfactory (UFIRS 2) at their most recent examination, provided they did not exceed \$100 million in total assets. Third, section 306 authorized the Agencies to increase this \$100 million threshold to \$175 million beginning on September 23, 1996, if the Agencies first determined that the increased amount is consistent with the principles of safety and soundness for insured depository institutions. Finally, section 306 required that, to qualify for the expanded examination cycle, an insured institution must not be subject to a formal enforcement proceeding or order. The remaining provisions of section 10(d) of the FDI Act were unchanged.

Section 2221 of **EGRPRA**<sup>4</sup> further amended section 10(d) of the FDI Act. Pursuant to

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<sup>3</sup> Rub. L. 103-325, 108 Stat. 2160.

<sup>4</sup> Pub. L. **104-208**, 110 Stat. 3009 (section 2221 is codified at 12 U.S.C. **1820(d)(10)**).

section 2221, the Agencies were authorized to increase to \$250 million the maximum asset size of UFIRS 2-rated institutions eligible for examination on an **18-month** cycle. EGRPRA also made the expanded examination cycle available to qualified Federal branches and agencies of foreign banks. The International Banking Act of 1978 (the **IBA**),<sup>5</sup> as amended by the Foreign Bank Supervision Enhancement Act of 1991,<sup>6</sup> requires an examination of each U.S. branch or agency of a foreign bank once during each 12-month period. Section 2214 of EGRPRA<sup>7</sup> amended the IBA to provide, among other things, that each Federal or State branch or agency of a foreign bank will be subject to on-site examination by the appropriate Federal or State banking agency as frequently as would a national or state bank, respectively. Consequently, U.S. branches or agencies of foreign banks are eligible for the **18-month** cycle provided that they meet the qualifying criteria outlined above.

In 1997, the Federal banking agencies issued a joint rule that was immediately effective upon the date of publication implementing section 306 of CDRI and section 2221 of EGRPRA. See 62 FR 6449 (Feb. 12, 1997). The interim rule was published with a request for public comment. As discussed in greater detail below, the public comments generally favored adoption of the expanded examination cycle rule as set forth in the interim rule. Accordingly, the Agencies hereby adopt the interim rule with only minor stylistic changes.

### **Comments Received**

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<sup>5</sup> Pub. L. 95-369, 92 Stat. 607 (codified at 12 U.S.C. 3101, et seq.).

<sup>6</sup> Pub. L. 102-242, 105 Stat. 2286, 2291, 2304 (amending, inter alia, 12 U.S.C. 3105(c)(1)(C)).

<sup>7</sup> Section 2214(a)(3) of EGRPRA is codified at 12 U.S.C. 3105(c)(1)(C).

In response to the interim rule request for comment, the Agencies received a total of 16 comments, including six from banking institutions, six from Federal Reserve Banks, and four from trade associations. Most agreed that the expansion of the 18-month examination cycle should be applied to UFIRS 1- and 2-rated domestic institutions with assets of \$250 million or less. Commenters favoring the proposed changes agreed that the application of an 18-month cycle would reduce regulatory burden on smaller, well run institutions that do not pose significant supervisory concerns. Commenters also noted that the rule is consistent with the Agencies' respective approaches to performance-based regulation and supervision.

One commenter suggested that a financial institution with a UFIRS rating of 1 or 2 should be allowed to elect either a 12-month or an 18-month exam cycle, and that each examination should cover, among other things, compliance issues and an examination of the financial institution's fiduciary and data processing operations. In response, the Agencies note that the examination cycle adopted in the interim rule and finalized by this rulemaking creates the generally applicable schedule. The primary regulator will have the option, however, to examine an institution as frequently as the regulator deems appropriate. The Agencies believe that this approach is an efficient and effective use of both financial institution and examiner resources. Should a financial institution wish to discuss particular issues with its primary regulator at a time other than when an examination is ongoing, the financial institution is encouraged to contact its regulator for assistance at any time.

### **Final Rule**

Based upon further deliberations by the Agencies and the comments received, the Agencies are adopting the interim rule in final form, with only minor stylistic changes.

Pursuant to the final rule, a domestic national or state financial institution will be eligible for an **18-month** examination schedule if the institution: (1) has total assets of \$250 million or less; (2) is well capitalized as defined in section 38(b)(1)(A) of the FDI Act (12 U.S.C. **1831o(b)(1)(A)**); (3) is well managed; (4) received a UFIRS rating of 1 or 2 at its most recent examination; (5) is not subject to a formal enforcement proceeding or order; and (6) has not undergone a change in control during the previous 12-month period.

The Agencies have determined that increasing the size limitation of UFIRS 2-rated institutions that are eligible for an **18-month** cycle is consistent with the safety and soundness of insured depository institutions. A longer examination cycle permits the Agencies to focus their resources on those segments of the banking and thrift industry that present the most immediate supervisory concern, while concomitantly reducing the regulatory burden on smaller, well run institutions that do not pose an equivalent level of supervisory concern. In lieu of the more frequent annual examinations that would otherwise be conducted for these institutions, the agencies rely upon off-site monitoring tools to identify potential problems in smaller, well managed institutions that present low levels of risk. Moreover, neither the statute nor the regulation limits, and the Agencies therefore retain, the authority to examine an insured depository institution more frequently. The Agencies that supervise **state-chartered** insured institutions also recognize that flexibility must be made available in the implementation of this regulation to accommodate requirements for annual examinations by various states.

The FDIC, Board, and OCC, which have jurisdiction over U.S. branches **and** agencies of foreign banks, are reviewing the issue of how to apply the qualifying criteria to these entities. Upon development of a method under which the **18-month** examination cycle

qualifying criteria can be applied to Federal branches and agencies, a separate rule will be issued for comment.

### **Effective Date of Final Rule**

The Agencies have determined that there is good cause to dispense with a 30day delayed effective date pursuant to 5 U.S.C. 553(d)(3). The expanded exam cycle was immediately effective upon publication of the interim rule in February, 1997. This final rule adopts the interim rule without any substantive change. While the Agencies invited interested parties to comment on the rule at that time, each agency already has implemented the expanded exam cycle, and insured depository institutions already have been complying with the new rule for approximately a year. Accordingly, depository institutions will not require any additional time to adjust their policies or practices in order to comply with the rule. Delaying the effective date simply would create confusion on the part of the banking industry concerning the applicability of the expanded exam cycle during the time between publication and some later effective date.

The Agencies also have determined. for the reasons stated in the preceding paragraph, that good cause exists to adopt an effective date that is before the first day of the calendar quarter that begins on or after the date on which the regulation is published, as would otherwise be required by section 302 of the **CDRI**.

### **Regulatory Flexibility Act**

The Regulatory Flexibility Act (the Act) (5 U.S.C. 601-612) does not apply to a rulemaking where a general notice of proposed rulemaking is not required, as is the case with the 18-month **examina**tion cycle rulemaking. See 5 U.S.C. 603 and 604. Accordingly, the



Act's requirements relating to an initial and final regulatory flexibility analysis are not applicable.

Even if the Act were to apply, the final rule will not have a significant economic impact on a substantial number of small entities. The **final** rule will reduce regulatory burdens on eligible banks and thrifts with assets of \$250 million or less. In addition, those depository institutions that are not eligible for the exemption from the statutorily prescribed 12-month examination cycle are not adversely affected by the final rule.

#### **Small Business Regulatory Enforcement Fairness Act**

Title II of the Small Business Regulatory Enforcement Fairness Act of 1996 (**SBREFA**)<sup>8</sup> provides generally for agencies to report rules to Congress and the General Accounting **Office** (GAO) for review. The reporting requirement is triggered when a Federal agency issues a final rule. The Agencies will file the appropriate reports with Congress and the GAO as required by SBREFA. The Office of Management and Budget has determined that the uniform rule promulgated by the Agencies does not constitute a "major rule" as defined by SBREFA.

#### **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the Agencies have determined that no collections of information pursuant to the Paperwork Reduction Act are contained in this final rule.

#### **OCC and OTS Executive Order 12866 Statement**

**The OCC** and OTS each independently has determined that this **final** rule is not a

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<sup>8</sup> Rub. L. 104-121.

significant regulatory action under Executive Order 12866.

### **OCC and OTS Unfunded Mandates Act of 1995 Statement**

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. ~~104-4~~, 109 Stat. 48 (March 22, 1995) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. Because the OCC and OTS have each independently determined that this final rule will not result in expenditures by state, local, and tribal governments, in the aggregate, or by the private sector, of more than \$100 million in any one year, the OCC and OTS have not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered. As discussed in the preamble, this final rule will have the effect of reducing regulatory burden on certain institutions.

### **List of Subjects**

#### **12 CFR Part 4**

Banks, banking, Freedom of information, Organization and functions (Government agencies), Reporting and recordkeeping requirements.

#### **12 CFR Part 208**

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Flood insurance, Mortgages, Reporting **and recordkeeping**

requirements, **Safety** and soundness. Securities.

12 CFR **Part** 337

Banks, banking, Reporting and recordkeeping requirements, Securities.

12 CFR Part 563

Accounting, Advertising, Conflicts of interest, Corporate opportunity, Crime, Currency, Investments. Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

**Office of the** Comptroller of the Currency

12 CFR Chapter I

Authority **and Issuance**

For the reasons set forth in the joint preamble, part 4 of chapter I of title 12 of the Code of Federal Regulations is amended as follows:

PART 4--ORGANIZATION AND FUNCTIONS, AVAILABILITY AND RELEASE OF INFORMATION, CONTRACTING OUTREACH PROGRAM

1. The authority citation for part 4 is revised to read as follows:

**Authority:** 12 U.S.C. 93a. Subpart A also issued under 5 U.S.C. 552; 12 U.S.C. 481, 1820(d). Subpart B also issued under 5 U.S.C. 552; E.O. 12600 (3 CFR, 1987 Comp., p. 235). Subpart C also issued under 5 U.S.C. 301, 552; 12 U.S.C. 481, 482, 1821(o), 1821(t); 18 U.S.C. 641, 1905, 1906; 31 U.S.C. 9701. Subpart D also issued under 12 U.S.C.

1833e.

2. In Subpart A, a new § 4.6 is added to read as follows:

**§ 4.6 Frequency of examination**

(a) **General.** The OCC examines national banks pursuant to authority conferred by 12 U.S.C. 481 and the requirements of 12 U.S.C. 1820(d). The OCC is required to conduct a full-scope, on-site examination of every national bank at least once during each 12-month period.

(b) **18-month rule for certain small institutions.** The OCC may conduct a full-scope, on-site examination of a national bank at least once during each **18-month** period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

- (1) The bank has total assets of \$250 million or less;
- (2) The bank is well capitalized as defined in 12 CFR part 6;
- (3) At the most recent examination, the OCC found the bank to be well managed;
- (4) At the most recent examination, the OCC assigned the bank a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (copies are available at the addresses specified in § 4.14 of this chapter);
- (5) The bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve System; and
- (6) No **person** acquired control of the bank during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(c) ~~Authority to conduct more frequent examinations~~. This section does not limit the authority of the OCC to examine any national bank as frequently as the agency deems necessary.

**[THIS SIGNATURE PAGE PERTAINS TO THE JOINT FINAL RULE ENTITLED  
“EXPANDED EXAMINATION CYCLE FOR CERTAIN SMALL INSURED  
INSTITUTIONS”]**

\_\_\_\_\_  
Date

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Eugene A. Ludwig  
Comptroller of the Currency

## Federal Reserve System

### 12 CFR Chapter II

For the reasons set forth in the joint preamble, the Board amends part 208 of chapter II of title 12 of the Code of Federal Regulations as follows:

#### **PART 208--MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for part 208 is revised to read as follows:

**Authority:** 12 U.S.C. 36, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1820(d)(8), 1823(j), 1828(o), 18310, 1831p-1, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 781(b), 781(g), 781(I), 78o-4(c)(5), 78q, 78q-1 and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

2. In Subpart A, a new § 208.26 is added to read as follows:

#### **§ 208.26 Frequency of examination.**

(a) **General.** The Federal Reserve examines insured member banks pursuant to authority conferred by 12 U.S.C. 325 and the requirements of 12 U.S.C. 1820(d). The Federal Reserve is required to conduct a full-scope, on-site examination of every insured member bank at least once during each 12-month period.

(b) **18-month rule for certain small institutions.** The Federal Reserve may conduct a

full-scope, on-site examination of an insured member bank at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

- (1) The bank has total assets of \$250 million or less;
- (2) The bank is well capitalized as defined in subpart B of this part (§ 208.33);
- (3) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve found the bank to be well managed;
- (4) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve assigned the bank a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (copies are available at the address specified in § 216.6 of this chapter);
- (5) The bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve System; and
- (6) No person acquired control of the bank during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(c) ~~Authority to conduct more frequent examinations.~~ **This** section does not limit the authority of the Federal Reserve to examine any insured member bank as frequently as the agency deems necessary.



[THIS SIGNATURE PAGE PERTAINS TO THE JOINT FINAL RULE ENTITLED  
“EXPANDED EXAMINATION CYCLE FOR CERTAIN SMALL INSURED  
INSTITUTIONS”]

By order of the Board of Governors of the Federal Reserve System,  
1998.

William W. Wiles  
Secretary of the Board.

Federal Deposit Insurance Corporation

12 CFR Chapter III

For the reasons set forth in the joint preamble, the Board of Directors of the FDIC amends part 337 of chapter III of title 12 of the Code of Federal Regulations to add § 337.12 to read as follows:

**PART 337 -- UNSAFE AND UNSOUND BANKING PRACTICES**

1. The authority citation for part 337 is revised to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1820(d)(10), 1821(f), 1828(j)(2), 1831f, 1831f-1.

2. Section 337.12 is added to read as follows:

§ 337.12 Frequency of examination

(a) **General**. The Federal Deposit Insurance Corporation examines insured state nonmember banks pursuant to authority conferred by section 10 of the Federal Deposit Insurance Act (12 U.S.C. 1820). The FDIC is required to conduct a full-scope, on-site examination of every insured state nonmember bank at least once during each 12-month period.

(b) **18-month rule** f o r c e r t a i n . The FDIC may conduct a full-scope,

on-site examination of an insured state nonmember bank at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

- (1) The bank has total assets of \$250 million or less;
- (2) The bank is well capitalized as defined in 12 CFR 325.103(b)(1);
- (3) At the most recent FDIC or applicable State banking agency examination, the FDIC found the bank to be well managed;
- (4) At the most recent FDIC or applicable State banking agency examination, the FDIC assigned the insured state nonmember bank a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (copies are available at the addresses specified in § 309.4 of this chapter);
- (5) The bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve System; and
- (6) No person acquired control of the bank during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(c) **Authority to conduct more frequent examinations.** This section does not limit the authority of the FDIC to examine any insured state nonmember bank as frequently as the agency deems necessary.

**[THIS SIGNATURE PAGE PERTAINS TO THE JOINT FINAL RULE ENTITLED  
“EXPANDED EXAMINATION CYCLE FOR CERTAIN SMALL INSURED  
INSTITUTIONS”]**

By order of the Board of Directors.

Dated at Washington, DC, this \_\_\_\_\_ day of \_\_\_\_\_, 1998.

FEDERAL DEPOSIT INSURANCE CORPORATION

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Executive Secretary  
(SEAL)

**Office** of Thrift Supervision

12 CFR Chapter V

For the reasons set forth in the joint preamble, the OTS amends part 563 of Chapter V of title 12 of the Code of Federal Regulations as follows:

**PART 563 - OPERATIONS**

1. The authority citation for part 563 is revised to read as follows:

Authority: 12 U.S.C. ~~375b~~, 1462, 1462a. ~~1463~~, 1464, 1467a. ~~1468~~, 1817, 1820, 1828. 3806; 42 U.S.C. ~~4106~~.

2. Section 563.171 is added to read as follows:

**§ 563.171** Frequency of examination.

(a) **General**. The OTS examines savings associations pursuant to authority conferred by 12 U.S.C. 1463 and the requirements of 12 U.S.C. 1820(d). The OTS is required to conduct a full-scope, on-site examination of every savings association at least once during each **12-month** period.

(b) **18-month rule for certain small institutions**. The OTS may conduct a full-scope, on-site examination of a savings association at least once during each **18-month** period, rather than each 12-month period as provided in paragraph (a) of this section, if the **following**

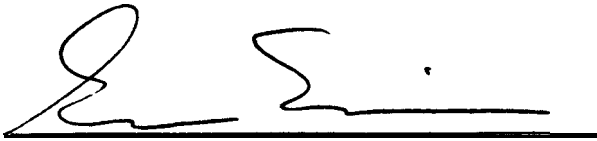
conditions are ~~satisfied~~:

- (1) The savings association has total assets of \$250 million or less;
  - (2) The savings association is well capitalized as defined in 12 **CFR** 565.4;
  - (3) At its most recent examination, the OTS found the savings association to be well managed;
  - (4) At its most recent examination, the OTS assigned the savings association a composite rating of 1 or 2, as defined in § 5 16.3(c) of this chapter;
  - (5) The savings association currently is not subject to a formal enforcement proceeding or order; and
  - (6) No person acquired control of the savings association during the preceding **12**-month period in which a full-scope, on-site examination would have been required but for this section.
- (c) ~~Authority to conduct more frequent examinations.~~ **This** section does not limit the authority of the OTS to examine any savings association as frequently as the agency deems necessary.

[THIS SIGNATURE PAGE PERTAINS TO THE JOINT FINAL RULE ENTITLED  
"EXPANDED EXAMINATION CYCLE FOR CERTAIN SMALL INSURED  
INSTITUTIONS"]

Dated: February 10 , 1998 .

By the Office of Thrift Supervision

A handwritten signature in black ink, appearing to read "E. Seidman", written over a solid horizontal line.

Ellen Seidman  
Director

**BILLING CODES**

4810-33-P (25 %)

6210-01-P (25%)

6714-01-P (25%)

6720-O 1 -P (25 %)