DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 30

[Docket No.____]

96-53

RIN______

FEDERAL RESERVE SYSTEM

12 CFR Part 208

[Docket No. R-0766]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 303, 308, and 364

RIN 3064-AB13

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 570

[Docket No. 96-53]
RIN 1550-AA97

Interagency Guidelines Establishing Standards for Safety and Soundness

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

ACTION: Final guidelines.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board of Governors), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the agencies) are amending the Interagency Guidelines Establishing Standards for Safety and Soundness (Guidelines) to include asset quality and earnings standards. The Guidelines were adopted pursuant to section 39 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831p-1).

EFFECTIVE DATE: ______________

FOR FURTHER INFORMATION CONTACT:

OCC: Emily R. McNaughton, National Bank Examiner (202/874-5170), Office of the Chief National Bank Examiner; David Thede, Senior Attorney (202/874-5210), Securities and Corporate Practices Division; or Mark Tenhundfeld, Senior Attorney (202/874-5090), Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

Board of Governors: David Wright, Project Manager (202/728-5854), Division of Banking Supervision and Regulation; Gregory A. Baer, Managing Senior Counsel (202/452-3236), Legal Division, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551.

FDIC: Robert W. Walsh, Manager, Planning and Program Development (202/898-6911) or Michael D. Jenkins, Examination Specialist (202/898-6896), Division of Supervision; or Susan VandenToorn, Counsel (202/898-8707) or Nancy L. Alper, Counsel (202/898-3720), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

OTS: William Magrini, Senior Project Manager (202/906-5744), Supervision Policy, Kevin Corcoran, Assistant Chief Counsel (202/906-6962), Teri M. Valocchi, Counsel (Banking and Finance) (202/906-7299), Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Framework

Section 132 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. 102-242, amended the Federal Deposit Insurance Act (FDI Act) by adding a new section (section 39, codified at 12 U.S.C. 1831p-1) that requires each Federal banking agency to establish by regulation certain safety and soundness standards for the insured depository institutions and depository institution holding companies for which it is the primary Federal regulator. As enacted in FDICIA, section 39(b) of the FDI Act required the agencies to establish standards by regulation specifying a maximum ratio of classified assets to capital and minimum earnings sufficient to absorb losses without impairing capital.

Section 318(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRIA), Pub. L. 103-325, which was enacted on September 23, 1994, eliminated the application of section 39 to depository institution holding companies and replaced the requirement that the agencies "specify" quantitative asset quality and earnings standards with a requirement that the agencies prescribe standards, by regulation or by guideline, relating to asset quality and earnings that the agencies determine to be appropriate.

B. Agencies' Proposals

The agencies published a joint notice of proposed rulemaking in the Federal Register on November 18, 1993 (59 FR 60802), that solicited comment on specific standards that would govern numerous facets of a depository institution's operations, including quantitative standards governing a depository institution's asset quality and earnings. On July 10, 1995 (60 FR 35674), the agencies adopted: (1) final guidelines in all areas except asset quality and earnings; and (2) a final rule establishing deadlines for submission and review of safety and soundness compliance plans which may be required for failure to meet one or more of the safety and soundness standards adopted in the Guidelines.[1] On the same day (60 FR 35688), the agencies also proposed revised guidelines concerning asset quality and earnings standards to address problems noted by many commenters with the quantitative standards. The primary concern of these commenters was that it was impossible to design standards that would be appropriate for every regulated institution. Because the CDRIA clarified that quantitative standards were not required, the agencies proposed to replace the quantitative standards with more comprehensive qualitative standards that emphasize monitoring, reporting, and preventive or corrective action appropriate to the size of the institution and the nature and scope of its activities.

The proposed asset quality standards required an institution to identify problem assets and estimate inherent losses. The proposal also required an institution to: (1) consider the size and potential risks of material concentrations of credit risk; (2) compare the level of problem assets to the level of capital and establish reserves sufficient to absorb anticipated losses on those and other assets; (3) take appropriate corrective action to resolve problem assets; and (4) provide periodic asset quality reports to the board of directors to assess the level of asset risk. The proposal noted that the complexity and sophistication of an institution's monitoring, reporting systems, and corrective actions should be commensurate with the size, nature, and scope of the institution's operations.

---

[1] For the OCC, these Guidelines appear as Appendix A to part 30; for the Board of Governors, these Guidelines appear as Appendix D to part 208; for the FDIC, these Guidelines appear as Appendix A to part 364; and for the OTS, these Guidelines appear as Appendix A to part 570.

The agencies proposed earnings standards requiring monitoring and reporting systems similar to those required in the standards for asset quality. The proposed earnings standards were intended to enhance early identification and resolution of problems. The standards required an institution to compare its earnings trends, relative to equity, assets, and other common benchmarks, with its historical experience and with the earnings trends of its peers. The proposed standards also provided that an institution should: (1) evaluate the adequacy of earnings given the institution's size, and complexity, and the risk profile of the institution's assets and operations; (2) assess the source, volatility, and sustainability of earnings; (3) evaluate the effect of nonrecurring or extraordinary income or expense; (4) take steps to ensure that earnings are sufficient to maintain adequate capital and reserves after considering asset quality and the institution's rate of growth; and (5) provide periodic reports with adequate information for management and the board of directors to assess earnings performance.

II. Discussion of comments

The agencies received a total of 31[2/] comments, some of which were sent to more than one agency. Commenters were overwhelmingly supportive of the proposal, particularly its reliance on qualitative and flexible standards in lieu of the quantitative standards originally proposed. Commenters noted that the more flexible guidelines embodied in the second proposed rule built upon a depository institution's own procedures for monitoring, reporting,

---

[2/] The Board of Governors received 14 comments, while the OCC, FDIC, and OTS received 8, 6, and 3, respectively.