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Subpart D—Prompt Corrective Action

SOURCE: 63 FR 37652, July 13, 1998, unless otherwise noted.

§ 208.40 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.

(a) *Authority.* Subpart D of Regulation H (12 CFR part 208, Subpart D) is issued by the Board of Governors of the Federal Reserve System (Board) under section 38 (section 38) of the FDI Act as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose and scope.* This subpart D defines the capital measures and capital levels that are used for determining the supervisory actions authorized under section 38 of the FDI Act. (Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized.) This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38. Certain of the provisions of this subpart apply to officers, directors, and employees of state member banks. Other provisions apply to any company that controls a member bank and to the affiliates of the member bank.

(c) *Other supervisory authority.* Neither section 38 nor this subpart in any way limits the authority of the Board under any other provision of law to take supervisory actions to address unsafe or unsound practices or conditions, deficient capital levels, violations of law, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the Board, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(d) *Disclosure of capital categories.* The assignment of a bank under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the Board or otherwise required by law, no bank may state in any advertisement or promotional material its capital category under this subpart or that the Board or any other Federal banking agency has assigned the bank to a particular capital category.

§ 208.41 Definitions for purposes of this subpart.

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used have the same meanings as set forth in section 38 and section 3 of the FDI Act.

(a) *Control*—(1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term *controlled* shall be construed consistently with the term *control.*

(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect to the shares.

(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate Federal banking agency for up to three one-year periods.

(b) *Controlling person* means any person having control of an insured depository institution and any company controlled by that person.

(c) *Leverage ratio* means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member

Banks: Tier 1 Leverage Measure (Appendix B to this part).

(d) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(e) *Risk-weighted assets* means total weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(f) *Tangible equity* means the amount of core capital elements as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage servicing assets to the extent that the Board determines that mortgage servicing assets may be included in calculating the bank's Tier 1 capital.

(g) *Tier 1 capital* means the amount of Tier 1 capital as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(h) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(i) *Total assets* means quarterly average total assets as reported in a bank's Report of Condition and Income (Call Report), minus intangible assets as provided in the definition of tangible equity. At its discretion the Federal Reserve may calculate total assets using a bank's period-end assets rather than quarterly average assets.

(j) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

[63 FR 37652, July 13, 1998, as amended at 63 FR 42674, Aug. 10, 1998]

§ 208.42 Notice of capital category.

(a) *Effective date of determination of capital category.* A member bank shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) *Notice of capital category.* A member bank shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Report of Condition and Income (Call Report) is required to be filed with the Board;

(2) A final report of examination is delivered to the bank; or

(3) Written notice is provided by the Board to the bank of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's capital category has changed as provided in paragraph (c) of this section or § 208.43(c).

(c) *Adjustments to reported capital levels and capital category*—(1) *Notice of adjustment by bank.* A member bank shall provide the Board with written notice that an adjustment to the bank's capital category may have occurred no later than 15 calendar days following the date that any material event occurred that would cause the bank to be placed in a lower capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent Call Report or report of examination.

(2) *Determination by Board to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the Board shall determine whether to change the capital category of the bank and shall notify the bank of the Board's determination.

§ 208.43 Capital measures and capital category definitions.

(a) Capital measures. For purposes of section 38 and this subpart, the relevant capital measures are:

(1) The total risk-based capital ratio;
(2) The Tier 1 risk-based capital ratio; and
(3) The leverage ratio.
(b) *Capital categories.* For purposes of section 38 and this subpart, a member bank is deemed to be:
(1) ''Well capitalized'' if the bank:
(i) Has a total risk-based capital ratio of 10.0 percent or greater; and
(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and
(iii) Has a leverage ratio of 5.0 percent or greater; and
(iv) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.
(2) ''Adequately capitalized'' if the bank:
(i) Has a total risk-based capital ratio of 8.0 percent or greater; and
(ii) Has a Tier 1 risk-based capital ratio of 4.0 percent or greater; and
(iii) Has:
(A) A leverage ratio of 4.0 percent or greater; or
(B) A leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth; and
(iv) Does not meet the definition of a ''well capitalized'' bank.
(3) ''Undercapitalized'' if the bank has:
(i) A total risk-based capital ratio that is less than 8.0 percent; or
(ii) A Tier 1 risk-based capital ratio that is less than 4.0 percent; or
(iii) Except as provided in paragraph (b)(2)(iii)(B) of this section, has a leverage ratio that is less than 4.0 percent; or
(iv) A leverage ratio that is less than 3.0 percent, if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth.
(4) ''Significantly undercapitalized'' if the bank has:
(i) A total risk-based capital ratio that is less than 6.0 percent; or
(ii) A Tier 1 risk-based capital ratio that is less than 3.0 percent; or
(iii) A leverage ratio that is less than 3.0 percent.
(5) ''Critically undercapitalized'' if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.
(c) *Reclassification based on supervisory criteria other than capital.* The Board may reclassify a well capitalized member bank as adequately capitalized and may require an adequately-capitalized or an undercapitalized member bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower capital category (except that the Board may not reclassify a significantly undercapitalized bank as critically undercapitalized) (each of these actions are hereinafter referred to generally as ''reclassifications'') in the following circumstances:
(1) *Unsafe or unsound condition.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that the bank is in unsafe or unsound condition; or
(2) *Unsafe or unsound practice.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that, in the most recent examination of the bank, the bank received and has not corrected, a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, liquidity, or sensitivity to market risk.

§ 208.44 Capital restoration plans.

(a) *Schedule for filing plan.* (1) *In general.* A member bank shall file a written capital restoration plan with the appropriate Reserve Bank within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the Board notifies the bank in writing that the plan is to be filed within a different period. An adequately capitalized bank that has been required, pursuant to § 208.43(c), to comply with supervisory actions as if the bank were undercapitalized is not required to submit a

capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 208.43(c), unless the Board notifies the bank that it must submit a new or revised capital plan. A bank that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate Reserve Bank within 45 days of receiving such notice, unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the Board instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A bank that is required to submit a capital restoration plan as the result of a reclassification of the bank pursuant to § 208.43(c) shall include a description of the steps the bank will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that Act by each company that controls the bank.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the Board shall provide written notice to the bank of whether the plan has been approved. The Board may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If the Board does not approve a capital restoration plan, the bank shall submit a revised capital restoration plan within the time specified by the Board. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized member bank (as defined in § 208.43(b)(3)) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as the Board approves a new or revised capital restoration plan submitted by the bank.

(e) *Failure to submit capital restoration plan.* A member bank that is undercapitalized (as defined in § 208.43(b)(3)) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement capital restoration plan.* Any undercapitalized member bank that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital plan.* A bank that has filed an approved capital restoration plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* Within 45 days of the effective date of Board approval of a capital restoration plan, or any amendment to a capital restoration plan, the Board shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank.* (1) *Limitation on Liability.* (i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific member bank that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank's total assets at the time the bank was notified or deemed to have notice that the bank was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank to the levels required for the bank to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the Board notifies the bank that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a bank shall be jointly and severally liable for the guarantee for such bank as required under section 38 and this subpart, and the Board may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank that is controlled by a company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks that have not submitted an acceptable capital restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a bank to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank shall be subject to the provisions of section 38 and this subpart that are applicable to banks that have failed in a material respect to implement a capital restoration plan.

§ 208.45 Mandatory and discretionary supervisory actions under section 38.

(a) *Mandatory supervisory actions.* (1) *Provisions applicable to all banks.* All member banks are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks.* Immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the Board monitor the condition of the bank (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the bank's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 3(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is significantly undercapitalized, or critically undercapitalized, or that the bank is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank failed to submit or implement in any material respect an acceptable capital restoration plan, the bank shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (a)(3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.32, that the bank is critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting the activities of the bank (section 38(h)(1)); and

(ii) Restricting payments on subordinated debt of the bank (section 38(h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the Board's discretion to take in connection with: A member bank that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; an officer or director of such bank; or a company that controls such bank, the Board shall follow the procedures for issuing directives under 12 CFR 263.202 and 263.204, unless otherwise provided in section 38 or this subpart.

Subpart E—Real Estate Lending and Appraisal Standards

SOURCE: 63 FR 37655, July 13, 1998, unless otherwise noted.

§ 208.50 Authority, purpose, and scope.

(a) *Authority.* Subpart E of Regulation H (12 CFR part 208, subpart E) is issued by the Board of Governors of the Federal Reserve System under section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o) and Title 11 of the Financial Institutions Reform, Recovery, and Enforcement Act (12 U.S.C. 3331–3351).

(b) *Purpose and scope.* This subpart E prescribes standards for real estate lending to be used by member banks in adopting internal real estate lending policies. The standards applicable to appraisals rendered in connection with federally related transactions entered into by member banks are set forth in 12 CFR part 225, subpart G (Regulation Y).

§ 208.51 Real estate lending standards.

(a) *Adoption of written policies.* Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) *Requirements of lending policies.* (1) Real estate lending policies adopted pursuant to this section shall be:

(i) Consistent with safe and sound banking practices;

(ii) Appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies shall establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the bank's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) *Monitoring conditions.* Each member bank shall monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) *Interagency guidelines.* The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies (contained in appendix C of this part) established by the Federal bank and thrift supervisory agencies.

Subpart F—Miscellaneous Requirements

SOURCE: 63 FR 37655, July 13, 1998, unless otherwise noted.