DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 30

[Docket No. 95–15]

FEDERAL RESERVE SYSTEM

12 CFR Part 208

[Docket No. R–0766]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 364

RIN 3064–AB13

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 570

[No. 95–114]

RIN 1550–AA54

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: Proposed 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 proposing asset quality and earnings standards to be added to the Interagency Guidelines Establishing Standards for Safety and Soundness (Guidelines) adopted pursuant to section 39 of the Federal Deposit Insurance Act (FDI Act) and appearing as an appendix to each of the agencies' standard for safety and soundness final rule published elsewhere in this separate part of the **Federal Register**. The agencies may require an insured depository institution to file a compliance plan for failure to meet these asset quality and earnings standards when adopted in final form.

DATES: Comments must be submitted by August 24, 1995.

ADDRESSES: Interested parties are invited to submit written comments to any or all of the agencies. All comments will be shared among the agencies.

OCC: Communications Division, 250 E Street, SW., Washington, DC 20219, attention: Docket No. 95–15. Comments will be available for public inspection and photocopying at the same location on business days between 9 a.m. and 5 p.m.

Board of Governors: Comments, which should refer to Docket No. R–0766, may be mailed to Mr. William Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Comments addressed to Mr. Wiles may also be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in room MP–500 between 9 a.m. and 5 p.m., except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FDIC: Robert E. Feldman, Acting Executive Secretary, Attention: Room F–402, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429. Comments may be hand-delivered to room F–400, 1776 F Street, NW., Washington, DC, on business days between 8:30 a.m. and 5 p.m. [FAX number (202) 898–3838]; Internet E-mail comments @fdic.gov. Comments will be available for inspection and photocopying in room 7118, 550 17th Street, NW., Washington, DC 20429, between 9 a.m. and 4:30 p.m. on business days.

OTS: Send comments to Chief, Dissemination Branch Records Management and Information Policy, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention Docket No. 95–114. These submissions may be hand delivered to 1700 G Street, NW., from 9 a.m. to 5 p.m. on business days; they may be sent by facsimile transmission to FAX number (202) 906–7755. Comments will be available for inspection at 1700 G Street, NW., from 1 p.m. until 4 p.m. on business days.

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, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board of Governors: David Wright, Supervisory Financial Analyst (202/728–5854), Division of Banking Supervision and Regulation; Scott G. Alvarez, Associate General Counsel (202/452–3583), 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; Lisa M. Stanley, Senior Counsel (202/898–7494), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: William Magrini, Project Manager (202/906–5744), Cathern Smith, Regional Coordinator (202/906–6614), Supervision; 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), added a new section 39 to the FDI Act which required 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 was 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.

On September 23, 1994 the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act) was enacted. Section 318(a) of the CDRI Act eliminated the requirement that standards prescribed under section 39 apply to depository institution holding companies and replaced the requirement that the agencies establish quantitative asset quality and earnings standards with a requirement that the agencies establish standards, by regulation *or* by guideline, relating to asset quality and earnings that the agencies determine to be appropriate. Pursuant to section 318 of the CDRI Act, these amendments have the same effective date as section 39 of the FDI Act, as provided in section 132(c) of FDICIA.

B. Agencies' Proposals

The agencies published a joint advance notice of proposed rulemaking in the **Federal Register**. 57 FR 31336 (July 15, 1992). The agencies received over 400 comment letters in response to the ANPR, with some letters submitted to more than one agency. The agencies' proposal requested comment on all aspects of the safety and soundness standards required to be prescribed pursuant to section 39 of the FDI Act, as enacted in FDICIA. Commenters strongly recommended that the agencies adopt general rather than specific standards. The agencies published a joint notice of proposed rulemaking in the **Federal Register** on November 18, 1993, 59 FR 60802. The agencies proposed quantitative asset quality and earnings standards in accordance with the statutory mandate set forth in FDICIA.

C. Final Rule and Interagency Guidelines Establishing Standards for Safety and Soundness

Each of the agencies has adopted a final rule (Final Rule) and Interagency Guidelines Establishing Standards for Safety and Soundness (Guidelines). The agencies' Final Rule establishes 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. The agencies' Final Rule and Guidelines are published elsewhere in this separate part of the **Federal Register**. The Guidelines will appear as appendices to each of the agencies' Final Rule.[1]

If adopted in final form, the agencies intend to incorporate these asset quality and earnings standards into the Guidelines. Thus, if adopted in final form, the agencies may require submission of a compliance plan for failure to meet the asset quality and earnings standards.

II. Request for Comment on Proposed Asset Quality and Earnings Standards

As enacted in FDICIA, section 39(b) of the FDI Act required the agencies to establish standards specifying a maximum ratio of classified assets to capital and minimum earnings sufficient to absorb losses without impairing capital. As amended by the CDRI Act, section 39(b) no longer requires the agencies to establish quantitative standards. Instead, the agencies are required to establish such standards relating to asset quality and earnings that the agencies determine to be appropriate.

Although commenters generally found the agencies' proposed quantitative standards acceptable, some commenters criticized the proposed standards as inflexible and simplistic. While the agencies believe that the standards as proposed are acceptable, they also believe that more comprehensive standards in these areas, as allowed under section 39(b), as amended, would be more useful and appropriate. Therefore, the agencies are proposing new standards for asset quality and earnings that emphasize monitoring, reporting and preventive or corrective action appropriate to the size of the institution and the nature and scope of its activities. These standards would be adopted by guideline.

The agencies believe the proposed standards are more likely to aid in the identification and resolution of emerging problems than setting minimum or maximum ratios. The agencies intend to continue to perform independent analyses that may include asset quality and earnings ratio analysis and will focus on an institution's oversight, reporting and corrective actions in these areas. The agencies believe that well-managed institutions should not find it necessary to modify their operations to comply with the proposed guidelines.

A. Standards Relating to Asset Quality

The agencies are proposing asset quality standards requiring monitoring and reporting systems to identify emerging problems and corrective actions to resolve them. The standards provide for institutions to identify problem assets and estimate inherent losses. Institutions would also be required 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 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. The agencies believe that the proposed asset quality standards are consistent with the practices of well-managed institutions and represent the long-standing and established expectations of the agencies.

B. Standards Relating to Earnings

The agencies are proposing earnings standards requiring monitoring and reporting systems similar to the standards for asset quality. The standards are intended to ensure prompt remedial actions to enhance early identification and resolution of problems. The standards require institutions to compare their earnings trends, relative to equity, assets and other common benchmarks with their historical experience and with their peers. The standards also provide that institutions 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 enough information for management and the board of directors to assess earnings performance.

As with the asset quality standards, the institution's monitoring, reporting systems and corrective actions should be commensurate with the size, nature and scope of the institution's operations. Once again, the agencies believe that these earnings standards are consistent with the practices of well-managed institutions and represent the long-standing and established expectations of the agencies.

The agencies propose to add to the Interagency Guidelines Establishing Standards for Safety and Soundness standards relating to asset quality and earnings as set forth below. The agencies request comment on all aspects of the proposed standards.

Regulatory Flexibility Act

Pursuant to Section 605(b) of the Regulatory Flexibility Act, the agencies certify that the proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This proposal adds asset quality and earnings standards to the Interagency Guidelines

[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.

Establishing Standards for Safety and Soundness.

Executive Order 12866

The OCC and the OTS have determined that this proposal is not a ''significant regulatory action'' for purposes of Executive Order 12866.

The proposed new paragraphs G and H of Section II of the Interagency Guidelines Establishing Standards for Safety and Soundness are as follows:

Asset Quality and Earnings Standards

G. *Asset Quality.* An insured depository institution should establish and maintain a system to identify problem assets and prevent deterioration in those assets in a manner commensurate with its size and the nature and scope of its operations. The institution should:

1. Conduct periodic asset quality reviews to identify problem assets and estimate the inherent losses in those assets;
2. Consider the size and potential risks of material asset concentrations;
3. Compare problem asset totals to capital and establish reserves that are sufficient to absorb estimated losses;
4. Take appropriate corrective action to resolve problem assets;
5. Provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset quality risk.

H. *Earnings.* An insured depository institution should establish and maintain a system to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves in a manner commensurate with its size and the nature and scope of its operations. The institution should:

1. Compare recent earnings trends relative to equity, assets or other commonly used benchmarks to the institution's historical results and those of its peers;
2. Evaluate the adequacy of earnings given the size, complexity and risk profile of the institution's assets and operations;
3. Assess the source, volatility and sustainability of earnings;
4. Evaluate the effect of nonrecurring or extraordinary income or expense;
5. Take steps to ensure that earnings are sufficient to maintain adequate capital and reserves after considering the institution's asset quality and growth rate; and
6. Provide periodic earnings reports with adequate information for management and the board of directors to assess earnings performance.

Dated: April 13, 1995.

Eugene A. Ludwig,

Comptroller of the Currency.

By Order of the Board of Governors of the Federal Reserve System, June 6, 1995.

William W. Wiles,

Secretary of the Board.

By order of the Board of Directors.

Dated at Washington, D.C., this 21st day of March, 1995.

Federal Deposit Insurance Corporation

Robert E. Feldman,

Deputy Executive Secretary.

Dated: May 25, 1995.

By the Office of Thrift Supervision.

Jonathan L. Fiechter,

Acting Director.

[FR Doc. 95–16564 Filed 7–7–95; 8:45 am]

BILLING CODES: 4810–33–P; 6210–01–P; 6714–01–P; 6720–01–P