



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 16-6

March 10, 2016

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Updates to the Expanded Examination Cycle for Certain State Member Banks
and U.S. Branches and Agencies of Foreign Banking Organizations**

Applicability to Community Banking Organizations: This guidance applies to certain state member banks and U.S. branches and agencies of foreign banks with less than \$1 billion in total assets meeting the criteria described in the letter.

The Federal Reserve is issuing this letter to provide an update on recent changes to the criteria for state member banks (SMB) and U.S. branches and agencies of foreign banks to be eligible for an expanded examination cycle of 18 months (as opposed to 12 months).

Section 10(d) of the Federal Deposit Insurance Act (FDI Act) generally requires the appropriate federal banking agency for an insured depository institution (IDI) to conduct a full-scope, on-site examination at least once every 12 months, but permits a longer cycle—at least once every 18 months—for IDIs that meet certain criteria, including the requirement that the IDI must have total assets below a specified size limit.¹ Section 83001 of the Fixing America's Surface Transportation Act² amended the FDI Act to increase from \$500 million to \$1 billion the total asset threshold below which a federal banking agency may examine an IDI on an 18-month examination cycle, rather than a 12-month examination cycle.

On February 29, 2016, the Board published in the *Federal Register* an interim final rule that amended Regulation H to raise the asset threshold for an SMB to be eligible for the 18-month examination cycle to the new statutory maximum, from less than \$500 million to less than \$1 billion.³ The interim final rule also made parallel changes to Regulation K, which governs the on-site examination cycle for Board-supervised U.S. branches and agencies of

¹ 12 U.S.C. 1820(d).

² Public Law No. 114-94, 129 Stat. 1312 (2015).

³ See 81 *Fed. Reg.* 10063 (February 29, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-02-29/pdf/2016-03877.pdf>.

foreign banks, consistent with section 7(c)(1)(C) of the International Banking Act of 1978.⁴ The interim final rule was made effective February 29, 2016, and was published jointly with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), both of which adopted similar changes to their regulations.

Accordingly, a SMB with less than \$1 billion in total assets may be eligible for an 18-month examination cycle if it satisfies the following criteria:

- 1) The SMB is well capitalized;
- 2) At the most recent Federal Reserve or applicable state banking agency examination,⁵ the Federal Reserve assigned a management component rating of “1” or “2” and a CAMELS composite rating of “1” or “2;”⁶
- 3) The SMB is currently not subject to a formal enforcement proceeding or order by the Federal Reserve or the FDIC; and
- 4) No person acquired control of the bank during the preceding 12-month period in which a full-scope examination would have been required but for the 18-month examination cycle eligibility provision.⁷

A U.S. branch or agency of a foreign bank with less than \$1 billion in total assets may be eligible for an 18-month on-site examination cycle if it received, at its most recent examination, a composite condition rating of “1” or “2” under the supervisory rating system and if it satisfies the following criteria:

- 1) Either: (a) the foreign bank’s most recently reported tier 1 and total risk-based capital ratios are at least 6 percent and 10 percent, respectively, on a consolidated basis; or (b) the branch or agency has maintained on a daily basis, over the past three quarters, eligible assets in an amount not less than 108 percent of the preceding quarter’s average third-party liabilities (determined consistent with applicable federal and state law) and sufficient liquidity is currently available to meet its obligations to third parties;
- 2) The branch or agency is not subject to a formal enforcement action or order by the Board, FDIC, or OCC; and
- 3) The branch or agency has not experienced a change in control during the preceding 12-month period in which a full-scope, on-site examination would have been required but for the 18-month examination cycle eligibility provision.⁸

⁴ 12 U.S.C. 3105(c)(1)(C).

⁵ The Board is permitted to conduct on-site examinations of SMBs on alternating 12-month or 18-month periods with the institution’s State supervisor, if the Board determines that the alternating examination conducted by the State carries out the purposes of section 10(d) of the FDI Act. 12 U.S.C. 1820(d)(3).

⁶ For more information on safety-and-soundness examination ratings, see SR letter 96-38, “Uniform Financial Institutions Rating System.”

⁷ 12 CFR 208.64.

⁸ 12 CFR 211.26(c).

The Federal Reserve may consider additional factors when determining the eligibility of a U.S. branch or agency of a foreign bank for an 18-month examination cycle, including whether (1) any of the individual components of the supervisory rating system of a branch or agency of a foreign bank is rated “3” or worse; (2) the results of any off-site surveillance indicate a deterioration in the condition of the branch or agency; (3) the size, relative importance, and role of a particular branch or agency in the context of the foreign bank’s entire U.S. operations otherwise necessitate an annual examination; and (4) the condition of the foreign bank gives rise to such a need.⁹

Implementation

Reserve Banks should immediately implement the expanded 18-month examination cycle eligibility for SMBs and the U.S. branches and agencies of foreign banks that have total assets of less than \$1 billion and that meet the other criteria of 12 CFR 208.64 or 211.26(c), as appropriate. The Federal Reserve maintains the authority to examine SMBs and the U.S. branches and agencies of foreign banks more frequently as necessary or appropriate, and Reserve Banks should exercise this authority as necessary or appropriate. The attachment to this letter, *Overview of State Member Bank Examination Frequency and Coordination*, briefly summarizes the overall SMB examination frequency framework.

The Federal Reserve is required to complete a Bank Secrecy Act (BSA)/anti-money laundering (AML) compliance program review at each safety-and-soundness examination conducted at a SMB or U.S. branch or agency of a foreign bank, which is typically every 12 months.¹⁰ However, Reserve Banks should conduct a BSA/AML compliance program review every 18 months at each SMB or U.S. branch or agency of a foreign bank that is eligible for and is examined on the extended 18-month examination cycle.

Reserve Banks are asked to distribute this letter to SMBs and Board-supervised U.S. branches and agencies of foreign banks that are within the scope of this guidance, as well as to appropriate supervisory and examination staff. Questions regarding this letter should be directed to the following staff in the Board’s Division of Supervision and Regulation: Richard Watkins, Deputy Associate Director, at (202) 452-3421, Anthony Cain, Manager, at (202) 912-4377, and Alex Kobulsky, Supervisory Financial Analyst, at (202) 452-2031. In addition, questions may be sent via the Board’s public website.¹¹

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Director

⁹ 12 CFR 211.26(c)(ii).

¹⁰ 12 U.S.C. 1818(s)(2) and 12 U.S.C. 1818(b)(4).

¹¹ See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

Attachment

- *Overview of State Member Bank Examination Frequency and Coordination*

Cross references to:

- SR letter 96-38, “Uniform Financial Institutions Rating System”

Supersedes:

- SR letter 07-8, “Expanded Examination Cycle for Certain Financial Institutions”
- SR letter 99-31, “Extended Examination Cycle for U.S. Branches and Agencies of Foreign Banks”
- SR letter 97-8, “Revisions to Examination Frequency Guidelines For State Member Banks”

Overview of State Member Bank Examination Frequency and Coordination¹

Total Asset Size of the State Member Bank (SMB) ²	Composite CAMELS rating of “1” or “2” from the last examination	Composite CAMELS rating of “3” from the last examination	Composite CAMELS rating of “4” or “5” from the last examination
\$0 to less than \$1 billion	Full-scope on-site exam every 18 months, provided: <ul style="list-style-type: none"> • SMB is well capitalized; • SMB received a CAMELS composite rating of “1” or “2” and a management component rating of “1” or “2” at the most recent Federal Reserve or applicable state banking agency examination; • SMB not subject to a formal enforcement proceeding or order by Federal Reserve or FDIC; and • No person acquired control of the SMB during the preceding 12-month period in which a full-scope exam would have been required but for the 18-month exam cycle Otherwise, full-scope exam every 12 months. May be eligible for alternate-year examination program (AEP). ³	Full-scope on-site exam every 12 months conducted by the Federal Reserve or jointly with the relevant state banking agency. A targeted exam conducted by the Federal Reserve or jointly with the state banking agency is also required annually for deteriorating institutions. ⁴	Two exams are required every 12 months. One of the two exams must be a full-scope exam. Both exams must be conducted by the Federal Reserve or jointly with the relevant state banking agency.
\$1-\$10 billion	Full-scope on-site exam every 12 months. May be eligible for AEP.		
Greater than \$10 billion and less than \$50 billion	Full-scope on-site exam every 12 months. Some SMBs rated CAMELS composite “1” and “2” may be eligible for an AEP. The SMB is subject to continuous monitoring, and exam activities are intensified based on the severity of issues at the bank.		
\$50 billion and above	Full-scope on-site exam every 12 months. The full-scope exam must be led by the Federal Reserve and may be joint with the relevant state banking agency. The SMB is subject to continuous monitoring, and exam activities are intensified based on the severity of issues at the bank.		

¹ This table provides a brief summary of examination (exam) frequency requirements for SMBs. See the Federal Reserve Board’s Regulation H, (12 CFR 208.64(b)), and Section 1000.1 of the *Commercial Bank Examination Manual* for more information on SMB exam frequency and coordination requirements.

² Exams of SMBs with more than \$10 billion are typically integrated into the consolidated supervision program at the bank holding company.

³ AEPs generally allow exams conducted in alternating years or alternating 18-month periods, as appropriate, to be conducted with the state banking agency along with Federal Reserve examiner presence. AEPs are implemented on a state-by-state basis. Consult the appropriate Reserve Bank for further information regarding eligibility and availability of an AEP in a particular state.

⁴ The Federal Reserve typically identifies deteriorating banks through off-site surveillance information. See Section 1020.1 of the *Commercial Bank Examination Manual* for more information.