

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 4
[Docket No. 98-11]
RIN 1557-AB60

FEDERAL RESERVE SYSTEM
12 CFR Part 211
[Regulation K; Docket No. R-1012]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 347
RIN 3064-AC15

Extended Examination Cycle for U.S. Branches and Agencies of Foreign Banks

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

ACTION: Interim rule with request for comment.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) are issuing this joint interim rule with request for comment to implement the provisions related to an extended examination cycle for U.S. branches and agencies of foreign banks set out in section 2214 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). United States branches and agencies of foreign banks with total assets of \$250 million or less are eligible to be considered for the 18-month examination cycle if they meet the qualifying criteria set out in this interim rule.

DATES: This interim rule is effective August 28, 1998. Comments must be received by October 27, 1998.

ADDRESSES: Comments should be directed to:

OCC: Communications Division, Office of the Comptroller of the Currency, 250 E Street S.W., Washington, D.C. 20219, Attention: Docket No.98-11. Comments will be available for public inspection and photocopying at the same location. Comments may also be sent by facsimile transmission to (202) 874-5274 or by electronic mail to regs.comments@occ.treas.gov.

Board: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, and refer to Docket No. R-1012. Comments addressed to Ms. Johnson 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 the security control room are accessible from the courtyard entrance on 20th

Street between Constitution Avenue and C Street, N.W. Comments may be inspected in room MP-500 between 9:00 a.m. and 5:00 p.m., except as provided in Section 261.14 of the Board's Rules Regarding the Availability of Information.

FDIC: Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m. (Fax number (202) 898-3838; Internet address: comments@fdic.gov) Comments may be inspected and photocopied in the FDIC Public Information Center, Room 100, 801 17th Street, N.W., Washington, D.C. between 9:00 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT:

OCC: Martha Clarke, Senior Attorney, International Activities (202/874-0680); or Howard Blacker, Senior International Advisor, International Banking & Finance (202/874-4730).

Board: Norah M. Barger, Assistant Director (202/452-2402), or Joseph J. Sciortino, Supervisory Financial Analyst (202/452-2294), Division of Banking Supervision and Regulation; or Sandra Richardson, Managing Senior Counsel (202/452-6406) or Jonathan D. Stoloff, Senior Attorney (202/ 452-3269), Legal Division.

FDIC: Karen Walter, Chief, International, Division of Supervision (202/898-3540); or Mark Mellon, Counsel, Regulation and Legislation Section, Legal Division (202/898-3854).

SUPPLEMENTARY INFORMATION:

Background

The International Banking Act of 1978 (the IBA),¹ as amended by the Foreign Bank Supervision Enhancement Act of 1991,² subjected U.S. branches and agencies of foreign banks to a 12-month examination cycle. Section 2214 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA)³ amended the IBA to provide that U.S. branches and agencies of foreign banks shall be subject to on-site examination as frequently as a national or state bank would be by its appropriate federal banking agency.

In general, national and state banks must be examined every 12 months. However, section

¹Pub. L. 95-369, 92 Stat. 607.

²Pub. L. 102-242, 105 Stat. 2286.

³Pub. L. 104-208, 110 Stat. 3009 (section 2214 is codified at 12 U.S.C. 3105(c)(1)).

111 of the Federal Deposit Insurance Corporation Improvement Act of 1991⁴ authorized an 18-month examination cycle for certain national and state banks with a composite rating of 1 under the Uniform Financial Institutions Rating System (UFIRS) and total assets of \$100 million or less. Section 306 of the Riegle Community Development and Regulatory Improvement Act of 1994⁵ expanded the availability of the 18-month examination cycle to certain national and state banks with a composite rating of 1 under UFIRS and total assets of \$250 million or less, as well as to certain national and state banks with a composite rating of 2 under UFIRS and total assets of \$100 million or less. Section 2221 of EGRPRA⁶ provided that anytime after September 23, 1996, U.S. bank supervisory agencies could extend the 18-month examination frequency cycle to certain national and state banks with a composite rating of 2 and total assets of \$250 million or less. Effective April 2, 1998, the Agencies issued a final rule that extended the examination cycle to 18 months for certain national and state banks that satisfy the requirements of section 2221 of EGRPRA.⁷ To be eligible for the extended cycle, the national or state bank must:

- (a) Have total assets of \$250 million or less;
- (b) Be rated a composite 2 or better under the UFIRS;
- (c) Be well capitalized;
- (d) Be well managed;
- (e) Not be subject to a formal enforcement action; and
- (f) Not have experienced a change of control during the preceding 12-month period in which a full-scope, on-site examination would have been required but for the extended cycle.

In view of the changes to the examination frequency of national and state banks, the Agencies are issuing an interim rule that similarly extends the examination cycle for certain U.S. branches and agencies of foreign banks. Accordingly, U.S. branches and agencies of foreign banks with total assets of \$250 million or less may be considered for an 18-month examination cycle provided that they meet the eligibility criteria described in this interim rule. The Agencies are seeking comment on any aspect of this rule.

The Agencies believe that an extended examination cycle for eligible U.S. offices of foreign banks will permit the Agencies to focus their resources on those offices that present the most immediate supervisory concern, while concomitantly reducing the regulatory burden on

⁴Pub. L. 102-242, 105 Stat. 2236 (section 111 is codified at 12 U.S.C. 1820(d)).

⁵Pub. L. 103-325, 108 Stat. 2160.

⁶Section 2221 is codified at 12 U.S.C. 1820(d)(10).

⁷63 FR 16377 (April 2, 1998).

smaller offices that do not pose a similar level of supervisory concern. The Agencies will continue to use off-site supervision techniques, including the submission of regulatory reports, to monitor the condition and any changes in the risk profile of offices scheduled to be examined on the extended 18-month cycle. Each agency retains authority to examine the offices of a foreign bank as frequently as the agency deems necessary.

Description of the Interim Rule

Under this interim rule, a U.S. branch or agency of a foreign bank is eligible to be considered for an 18-month examination cycle if the office meets the criteria listed below and if there are no other factors that cause the appropriate federal banking agency to examine the branch or agency more frequently. To qualify for an 18-month examination cycle, the U.S. branch or agency of a foreign bank must:

- (a) Have total assets of \$250 million or less;
- (b) Have received a composite ROCA supervisory rating of 1 or 2 at its most recent examination;⁸
- (c) Satisfy the requirements of either the following paragraph (1) or (2):
 - (1) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, Tier 1 and risk-based capital ratios of at least 6 percent and 10 percent, respectively, on a consolidated basis; or
 - (2) The branch or agency has maintained on a daily basis over the past three quarters, eligible assets (determined consistent with applicable federal and state law) in an amount not less than 108 percent of the preceding quarter's average third party liabilities and sufficient liquidity is currently available to meet its obligations to third parties;
- (d) Not be subject to a formal enforcement action or order by the Board, FDIC or OCC; and
- (e) Not have 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 extended cycle.

Each agency retains the authority to examine a U.S. branch or agency of a foreign bank as frequently as the agency deems necessary. Factors that the Agencies will consider when deciding whether more frequent examinations are necessary include, but are not limited to, whether: (a) any of the individual components of the ROCA rating of the U.S. office is rated 3 or worse; (b) the results of any off-site supervision indicate a deterioration in the condition of the office; (c) the size, relative importance, and role of a particular office when reviewed in the context of the

⁸The supervisory rating system for U.S. branches and agencies of foreign banks is referred to as ROCA. The four components of ROCA are: risk management, operational controls, compliance, and asset quality.

foreign bank's entire U.S. operations otherwise necessitates an annual examination (including, for example, whether the office generates a significant level of assets that are booked elsewhere); and (d) the condition of the foreign bank itself gives rise to such a need. In general, the Agencies will make their determination whether to apply the 18-month examination cycle to a particular U.S. branch or agency based on the overall risk assessment for that office, as well as the factors noted herein.

Section 2214 of EGRPRA directs that the U.S. branches and agencies of foreign banks should be subject to on-site examinations as often as U.S. banks. The criteria for determining eligibility of U.S. offices of a foreign bank for an expanded examination cycle differ in certain respects from the criteria applicable to U.S. banks for this purpose. These differences are necessary to adjust for the obvious structural differences that exist between U.S. banks and U.S. offices of foreign banks (e.g., the U.S. offices of foreign banks often constitute only a small part of foreign banks' worldwide operations and the role of the Agencies with regard to the U.S. offices is limited to that of host country supervisor), as well as the supervisory implications that flow from these basic structural differences.

The Agencies will use a number of criteria as a proxy for the well-managed criterion applicable to U.S. banks, including the ROCA component and composite ratings, the existence of any formal enforcement action or order issued by an agency, and the other discretionary standards described above. With regard to the well-capitalized criterion applicable to U.S. banks for these purposes, the Agencies will take into account the foreign bank's capital adequacy ratios, as well as, in appropriate circumstances, whether the U.S. offices of the foreign bank have sufficient eligible assets and liquidity to meet their obligations to third parties. The Agencies believe that evaluating the U.S. branches and agencies of foreign banks on the basis of the criteria described above for purposes of determining eligibility for an expanded examination cycle is consistent with the requirements of section 2214 of EGRPRA.

Effective Date of Interim Rule

The Agencies find good cause for issuing this interim rule without prior notice and the opportunity for comment, as well as for dispensing with the 30-day delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA), 5 U.S.C. 551 *et seq.* The interim rule confers a benefit on certain small U.S. branches and agencies of foreign banks by reducing the regulatory burden associated with more frequent on-site examinations. Conversely, this interim rule does not increase the frequency of examinations or otherwise increase the regulatory burden for any U.S. branch or agency of a foreign bank. Such institutions, therefore, are not adversely affected by the interim rule. Under these circumstances, the Agencies conclude that prior notice and comment procedures are unnecessary and would be contrary to the public interest. 5 U.S.C. 553(b)(B).

In addition, the Agencies have determined that this interim rule relates to examination schedules, which are a matter of internal agency procedure rather than a rule of substantive effect on bank activities and authority. See Donovan v. Wollaston Alloys, Inc., 695 F.2d 1, 9 (1st Cir. 1982). Determining when a regulated institution is to be examined is

based, in part, on examiner availability, the Agencies' need to plan examiner time in advance, and other issues relevant to the internal operations of the Agencies. Therefore, this interim rule is exempt from the APA's public notice requirement. 5 U.S.C. 553(b)(3)(A).

Regulatory Flexibility Act

An initial regulatory flexibility analysis under the Regulatory Flexibility Act is only required whenever an agency is required to publish a general notice of proposed rulemaking for any proposed rule. 5 U.S.C. 603. As noted previously, the Agencies have determined that this proposed rulemaking is exempt from the requirements of the APA. Accordingly, an initial regulatory flexibility analysis is not required.

Even if the Act were to apply, the interim rule will not have a significant economic impact on a substantial number of small entities. The interim rule will reduce regulatory burden on eligible U.S. branches and agencies of foreign banks with assets of \$250 million or less. In addition, those entities that are not eligible for the exemption from the statutorily prescribed 12-month examination cycle will not be adversely affected by the interim rule.

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 interim rule.

OCC Executive Order 12866 Statement

The OCC has determined that this interim rule is not a significant regulatory action under Executive Order 12866.

OCC 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 has determined that this interim 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 has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered. As discussed in the preamble, this interim 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 211

Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements.

12 CFR 347

Allocated transfer risk reserve, Banks, banking, Bank deposit insurance, Bank mergers, Credit, Foreign banking, Foreign branches, Foreign investments, Insured branches, International lending, International operations, Investments, Reporting and disclosure of international assets, Reporting and recordkeeping requirements, Reserves on certain international assets.

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), and 3105(c)(1). 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, the heading of § 4.6 is revised to read as follows:

§ 4.6 Frequency of examination of national banks.

3. In Subpart A, a new § 4.7 is added to read as follows:

§ 4.7 Frequency of examination of Federal agencies and branches.

(a) General. The OCC examines Federal agencies and Federal branches (as these entities are defined in § 28.11(h) and (i), respectively) pursuant to the authority conferred by 12 U.S.C. 3105(c)(1)(C). Except as noted in paragraph (b) of this section, the OCC will conduct a full-scope, on-site examination of every Federal branch and agency at least once during each 12-month period.

(b) 18-month rule for certain small institutions.—(1) Mandatory standards. The OCC may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the Federal branch or agency:

(i) Has total assets of \$250 million or less;

(ii) Has received a composite ROCA supervisory rating (which rates risk management, operational controls, compliance, and asset quality) of 1 or 2 at its most recent examination;

(iii) Satisfies the requirements of either the following paragraph (A) or (B):

(A) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, Tier 1 and total risk-based capital ratios of 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 (determined consistent with applicable federal and state law) in an amount not less than 108 percent of the preceding quarter's average third party liabilities and sufficient liquidity is currently available to meet obligations to third parties;

(iv) Is not subject to a formal enforcement action or order by the Federal Reserve Board, the Federal Deposit Insurance Corporation, or the OCC; and

(v) 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 this section.

(2) Discretionary standards. In determining whether a Federal branch or agency is eligible for an 18-month examination cycle pursuant to this paragraph (b), the OCC may consider additional factors, including, but not limited to, whether:

(1) Any of the individual components of the ROCA rating of the Federal branch or agency is rated "3" or worse;

(2) The results of any off-site supervision indicate a deterioration in the condition of the Federal branch or agency;

(3) The size, relative importance, and role of a particular office when reviewed 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.

(c) Authority to conduct more frequent examinations. Nothing in paragraphs (a) or (b) of this section limits the authority of the OCC to examine any Federal branch or agency as frequently as the OCC deems necessary.

August 12, 1998
Date

(signed Julie L. Williams)
Julie L. Williams
Acting Comptroller of the Currency

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For reasons set forth in the joint preamble, the Board amends 12 CFR Part 211 as set forth below:

PART 211— INTERNATIONAL BANKING OPERATIONS (REGULATION K) **Subpart B —Foreign Banking Organizations**

1. The authority citation for part 211 continues to read as follows:

Authority: 12 U.S.C. 221 et seq., 1818, 1835a, 1841 et seq., 3101 et seq., 3109 et seq.

2. In Subpart B, § 211.26 is amended by revising paragraph (c) to read as follows:

§ 211.26 Examination of offices and affiliates of foreign banks.

* * * * *

(c) Frequency of on-site examination.—(1) General. Each branch or agency of a foreign bank shall be examined on-site at least once during each 12-month period (beginning on the date the most recent examination of the office ended) by:

(i) The Board;

(ii) The FDIC, if the branch of the foreign bank accepts or maintains insured deposits;

(iii) The Comptroller, if the branch or agency of the foreign bank is licensed by the Comptroller; or

(iv) The state supervisor, if the office of the foreign bank is licensed or chartered by the state.

(2) 18-month cycle for certain small institutions.—(i) Mandatory standards. The Board may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as required in paragraph (c)(1) of this section, if the branch or agency:

(A) Has total assets of \$250 million or less;

(B) Has received a composite ROCA supervisory rating (which rates risk management, operational controls, compliance, and asset quality) of 1 or 2 at its most recent examination;

(C) Satisfies the requirement of either the following paragraph (1) or (2):

(1) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, Tier 1 and total risk-based capital ratios of at least 6 percent and 10 percent, respectively, on a consolidated basis; or

(2) The branch or agency has maintained on a daily basis, over the past three quarters, eligible assets (determined consistent with applicable federal and state law) in an amount not less than 108 percent of the preceding quarter's average third party liabilities and sufficient liquidity is currently available to meet its obligations to third parties;

(D) Is not subject to a formal enforcement action or order by the Board, FDIC, or OCC; and

(E) 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 this section.

(ii) Discretionary standards. In determining whether a branch or agency of a foreign bank is eligible for an 18-month examination cycle pursuant to this paragraph (c)(2), the Board may consider additional factors, including, but not limited to whether:

(A) Any of the individual components of the ROCA supervisory rating of a branch or agency of a foreign bank is rated "3" or worse;

(B) The results of any off-site surveillance indicate a deterioration in the condition of the office;

(C) The size, relative importance, and role of a particular office when reviewed in the context of the foreign bank's entire U.S. operations otherwise necessitate an annual examination; and

(D) The condition of the foreign bank gives rise to such a need.

(3) Authority to conduct more frequent examinations. Nothing in paragraphs (c)(1) and (2) of this section limits the authority of the Board to examine any U.S. branch or agency of a foreign bank as frequently as it deems necessary.

* * * * *

By order of the Board of Governors of the Federal Reserve System, August 24, 1998.

(signed Jennifer J. Johnson)
Jennifer J. Johnson
Secretary of the Board.

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Directors of the FDIC amends part 347 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 347—INTERNATIONAL BANKING

1. The authority citation for part 347 continues to read as follows:

Authority: 12 U.S.C. 1813, 1815, 1817, 1819, 1820, 1828, 3103, 3104, 3105, 3108; Title IX, Pub. L. 98-181, 97 Stat. 1153.

2. Section 347.214 is added to subpart B to read as follows:

§ 347.214 Examination of branches of foreign banks.

(a) Frequency of on-site examination. Each branch or agency of a foreign bank shall be examined on-site at least once during each 12-month period (beginning on the date the most recent examination of the office ended) by:

- (1) The Board of Governors of the Federal Reserve System (Board);
- (2) The FDIC, if the branch of the foreign bank accepts or maintains insured deposits;
- (3) The Office of the Comptroller of the Currency (OCC), if the branch or agency of the foreign bank is licensed by the Comptroller; or
- (4) The state supervisor, if the office of the foreign bank is licensed or chartered by the state.

(b) 18-month cycle for certain small institutions.—(1) Mandatory standards. The FDIC may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the branch or agency:

- (i) Has total assets of \$250 million or less;
 - (ii) Has received a composite ROCA supervisory rating (which rates risk management, operational controls, compliance, and asset quality) of 1 or 2 at its most recent examination;
 - (iii) Satisfies the requirement of either the following paragraph (A) or (B):
 - (A) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, Tier 1 and total risk-based capital ratios of 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 (determined consistent with applicable federal and state law) in an amount not less than 108 percent of the preceding quarter's average third party liabilities and sufficient liquidity is currently available to meet its obligations to third parties;
 - (iv) Is not subject to a formal enforcement action or order by the Board, FDIC, or the OCC; and
 - (v) 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 this section.
- (2) Discretionary standards. In determining whether a branch of a foreign bank is eligible for an 18-month examination cycle pursuant to this paragraph (b), the FDIC may consider additional factors, including, but not limited to, whether:
- (i) Any of the individual components of the ROCA supervisory rating of a branch of a foreign bank is rated "3" or worse;
 - (ii) The results of any off-site monitoring indicate a deterioration in the condition of the branch;
 - (iii) The size, relative importance, and role of a particular branch when reviewed in the context of the foreign bank's entire U.S. operations otherwise necessitate an annual examination; and
 - (iv) The condition of the parent foreign bank gives rise to such a need.
- (c) Authority to conduct more frequent examinations. Nothing in paragraphs (a) and (b) of this section limits the authority of the FDIC to examine any U.S. branch or agency of a foreign bank as frequently as it deems necessary.

By order of the Board of Directors.

Dated at Washington, DC, this 7th day of July, 1998.

FEDERAL DEPOSIT INSURANCE CORPORATION

(signed James D. LaPierre)
James D. LaPierre
Deputy Executive Secretary
(SEAL)