BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

**SR 18-7**

**October 1, 2018**

**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 $3 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 210 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) amends section 10(d) of the FDI Act to increase from $1 billion to $3 billion the total asset threshold below which an IDI may qualify for the 18-month examination cycle

On August 29, 2018, 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 from less than $1 billion in total assets to the new statutory maximum, which is less than $3 billion in total assets.[2] 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 foreign banks, consistent with section 7(c)(1)(C) of the International

[1] 12 U.S.C. 1820(d).

[2] See 83 *Fed. Reg.* 43961 (August 29, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-08-29/pdf/2018-18685.pdf.

Banking Act of 1978.[3] The interim final rule was made effective August 29, 2018, 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 $3 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,[4] the Federal Reserve assigned a management component rating of "1" or "2" and a CAMELS composite rating of "1" or "2;"[5]
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, on-site examination would have been required but for the 18-month examination cycle eligibility provision.[6]

A U.S. branch or agency of a foreign bank with less than $3 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[7] and 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]

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[3] 12 U.S.C. 3105(c)(1)(C).

[4] 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).

[5] For more information on safety-and-soundness examination ratings, see SR letter 96-38, "Uniform Financial Institutions Rating System."

[6] 12 CFR 208.64.

[7] For more information on the ratings system for U.S. branches and agencies of foreign banks, see SR letter 00-14, "Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations."

[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 on-site 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**

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 $3 billion and that meet the other criteria of 12 CFR 208.64 or 211.26(c), as appropriate, was made effective August 29, 2018, the date of publication in the *Federal Register*. 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 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: Jonathan Rono, Manager, at (202) 721-4568; 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

**Cross references to:**

- SR letter 00-14, "Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations"
- SR letter 96-38, "Uniform Financial Institutions Rating System"

[9] 12 CFR 211.26(c)(2)(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.

**Supersedes**:

- SR letter 17-2, “Updates to the Expanded Examination Cycle for Certain State Member Banks and U.S. Branches and Agencies of Foreign Banking Organizations”