Comptroller's Handbook

Examination Process

Problem Bank Supervision

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References to reputation risk have been removed from this booklet as of March 20, 2025. Removal of reputation risk references is identified by a strikethrough. Refer to OCC Bulletin 2025-4.

Office of the
Comptroller of the Currency

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Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Problem Bank Supervision," is prepared for use by OCC examiners in connection with their examination and supervision of national banks, federal savings associations, and federal branches and agencies of foreign banking organizations (collectively, banks).[1] Each bank is different and may present specific issues. Accordingly, examiners should apply the information in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks, federal savings associations (FSA), and covered savings associations (CSA) are referred to separately.[2]

This booklet

- includes information regarding timely identification and rehabilitation of problem banks and advanced supervision, enforcement, and resolution when conditions warrant.
- includes a comprehensive discussion of the OCC's authority under 12 USC 1831o and 12 CFR 6, "Prompt Corrective Action" (PCA).
- complements other booklets of the *Comptroller's Handbook* and topical OCC and interagency issuances.
- should be supplemented with appropriate examiner consultation with the supervisory office, subject matter experts, Licensing Division staff, and OCC legal counsel.

The United States has weathered several periods of significant bank failures. Two examples are the savings and loan crisis beginning in 1986 and the financial crisis beginning in 2008. During the savings and loan crisis, 1,617 banks and 1,295 savings and loan associations failed or required financial assistance.[3] The Federal Deposit Insurance Corporation (FDIC) resolved 489 banks between 2008 and 2013.[4] The cause of failures or near-failures varied. Common themes that contributed to the failures included excessive risk-taking and growth, deficient underwriting and credit administration, dominant influence by managers or directors, excessive asset or liability concentrations, and weak risk management.

Experience from past financial crises shows that a bank's condition can deteriorate quickly, especially if significant concentrations or fraud is involved. History has shown that poor decisions, poor implementation of decisions, weak risk management, and excessive risk-

[1] For more information regarding federal branches and agencies, refer to appendix B of this booklet.

[2] When this booklet distinguishes by charter type, references to "national banks" generally also apply to federal branches and agencies of foreign banking organizations unless otherwise specified. For more information regarding applicability of laws, regulations, and guidance to federal branches and agencies, refer to the "Federal Branches and Agencies Supervision" booklet of the *Comptroller's Handbook*. Certain FSAs may make an election to operate as a CSA. For more information, refer to OCC Bulletin 2019-31, "Covered Savings Associations Implementation: Covered Savings Associations," and 12 CFR 101, "Covered Savings Associations."

[3] Refer to *Managing the Crisis: The FDIC and RTC Experience*, FDIC.

[4] Refer to *Crisis and Response: An FDIC History, 2008-2013*, FDIC.

taking generally occur during good economic times. An FDIC study indicates that of the banks that failed between 1980 and 1994, 36 percent had composite ratings of 1 or 2 within two years of failure.[5] This underscores the importance of timely detection and correction of deficiencies.

The OCC defines a problem bank as a bank with a CAMELS or ROCA composite rating of 3, 4, or 5.[6] The primary goal of problem bank supervision is to rehabilitate the bank to a safe and sound condition by requiring management and the board to correct the bank's deficiencies and improve the bank's financial condition. When an insured problem bank's condition deteriorates to the point that it is no longer viable, the OCC coordinates with the FDIC to resolve the bank in an orderly manner and at the least cost to the Deposit Insurance Fund (DIF). This booklet provides information for OCC examiners for achieving rehabilitation and resolution objectives.

Most problem banks are also in troubled condition as defined in 12 CFR 5.51(c)(7). Specifically, a bank is in troubled condition if it

- has a CAMELS composite rating of 4 or 5,
- is subject to a cease-and-desist order, consent order, or formal written agreement that requires action to improve the bank's financial condition, unless otherwise informed in writing by the OCC, or
- is informed by the OCC in writing that the OCC has designated the bank in troubled condition.

Troubled condition status triggers prior notice requirements for changes in directors and senior executive officers under 12 CFR 5.51 (commonly referred to as Section 914 requirements)[7] and restrictions on golden parachute payments under 12 CFR 359. Problem banks are often also subject to other restrictions, such as loss of eligible bank[8] status regarding corporate filings. Loss of eligible bank status under 12 CFR 5 limits the bank's ability to receive expedited OCC review of certain filings. Additionally, pursuant to 12 CFR 24.2(e), a national bank[9] that is a problem bank may lose status as an eligible bank

[5] Refer to *History of the Eighties–Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s,* FDIC.

[6] A bank's composite rating under the Uniform Financial Institutions Rating System, or CAMELS, integrates ratings from six component areas: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. ROCA is the interagency uniform supervisory rating system for federal branches and agencies. ROCA integrates ratings from four component areas: risk management, operational controls, compliance, and asset quality. For more information about the CAMELS and ROCA rating systems, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

[7] For more information, refer to the "Changes in Directors and Senior Executive Officers" booklet of the *Comptroller's Licensing Manual*.

[8] 12 CFR 5 refers separately to "eligible banks" and "eligible savings associations." The definition of those terms in 12 CFR 5.3 is the same. Therefore, the term "eligible bank" under 12 CFR 5 refers to both national banks and federal savings associations.

[9] 12 CFR 24.2(e) applies only to national banks; no similar provision applies to federal savings associations.

regarding filings for public welfare investments under 12 CFR 24. Loss of eligible bank status under 12 CFR 24 limits the ability of a national bank to provide an after-the-fact notification when the bank makes a public welfare investment under 12 CFR 24.

Risk-based supervision focuses on evaluating risk, identifying existing and emerging problems, and ensuring that bank management takes corrective action before the problems affect the bank's condition. Examiners are responsible for identifying and examining red flags to determine if the red flags indicate emerging risks, potential deficiencies, or adverse conditions. Emerging risks, potential deficiencies,[10] and adverse conditions may not be evident to bank management or directors. Examiners must not dismiss deficiencies just because a bank is well-rated or financially strong. Failure to identify and communicate the OCC's concern with deficiencies in a timely manner can result in a recoverable situation deteriorating into a serious, intractable problem. The point when an examiner identifies deficiencies and recognizes the possible effect on a bank's condition or risk profile is critical and can lead to effective corrective action. It is not unusual for senior management or directors to overlook or underestimate the seriousness of deficiencies or emerging risks while a bank's financial condition is sound. It is particularly important for examiners to assess deficiencies and their potential impact on the bank's condition or risk profile, prioritize findings by significance, and clearly communicate the OCC's expectations to bank management and the board.

Examiners should identify and document bank practices or conditions that are unsafe or unsound.[11] In assessing whether practices or conditions are unsafe or unsound, examiners should be familiar with 12 CFR 30, appendix A, "Interagency Guidelines Establishing Standards for Safety and Soundness," which establishes operational and managerial standards for banks'

- internal controls and information systems.
- internal audit system.
- loan documentation.
- credit underwriting.
- interest rate exposure.
- asset growth.
- asset quality.
- earnings.
- compensation, fees, and benefits.

Candid communication requires examiners to take a skilled, tactful, and balanced approach to accomplish supervisory objectives. The risk of damaging a relationship with a banker is

[10] The term "deficiencies" refers collectively to deficient practices and violations of laws, regulations, final agency orders, conditions imposed in writing, and written agreements. For more information, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook.*

[11] An unsafe or unsound practice is generally any action or lack of action that is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the DIF.

never an acceptable reason for an examiner to avoid or defer bringing concerns to the attention of management and directors. Clear communication and well-articulated corrective actions typically reduce the ultimate cost of correcting deficiencies and restoring the bank to a safe and sound condition.

Corrective actions are likely to be most successful and least costly while a bank's condition is sound and management's attention is not divided among multiple deficiencies. Deteriorating economic conditions, when coupled with a bank's failure to address previously identified weaknesses, warrant stronger supervisory action.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) was designed to ensure timely identification of insured problem banks and least-cost resolution to the DIF. FDICIA provides a mandatory framework for corrective action in insured problem banks[12] but does not eliminate the critical need for examiner judgment. In exercising this judgment, examiners are expected to identify problem banks and pursue timely rehabilitation or resolution of these banks, as appropriate. Problem bank supervision can involve making difficult recommendations, such as using supervisory and legal authorities to resolve a bank when capital remains but the bank is no longer viable and additional rehabilitation is futile. When a bank has reached this state of financial distress, its composite rating is 4 or 5.[13]

The OCC plans for resolution if a bank's viability is doubtful or the bank's condition or management and the board's actions otherwise warrant consideration of receivership or conservatorship. The OCC in some circumstances may require a bank to sell, merge, or liquidate.

Supervisory Responsibilities for Problem Banks

The OCC's Special Supervision Division is responsible for supervising 5-rated community banks and certain 4-rated or 3-rated community banks. Banks supervised by the Special Supervision Division are referred to as nondelegated, meaning that supervision is not delegated to one of the other OCC supervision units.[14]

The OCC automatically considers 5-rated community banks and national trust banks to be nondelegated absent extenuating circumstances. Ideally, the Special Supervision Division should assume supervisory responsibility of a deteriorating community bank or national trust bank before it becomes composite 5-rated. The supervisory office should consult with the Special Supervision Division about possible early transfer of responsibility for banks with significant deficiencies. The Special Supervision Division may assume responsibility for other community banks or national trust banks with significant deterioration or unique

[12] Refer to 12 USC 1831o, 12 CFR 6, and the "Prompt Corrective Action" section of this booklet.

[13] Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for definitions of each composite rating.

[14] For more information about the OCC's organizational structure for bank supervision, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

circumstances. Designating any bank as nondelegated is a joint decision between the applicable deputy comptroller and the Deputy Comptroller for Special Supervision, based on case-specific facts and circumstances. Deputy comptrollers should consider designating a 4-rated community bank or national trust bank as nondelegated when

- the bank's financial condition is expected to deteriorate, and risk of failure is high.
- the bank has one or more 5-rated component ratings, particularly if management is 5-rated.
- there is evidence of fraud, insider abuse, or substantive financial reporting errors, particularly when the issues warrant a nondelegated order of investigation.
- the bank has complex or novel issues that involve extensive coordination with other federal agencies (e.g., Financial Crimes Enforcement Network, U.S. Department of Justice, or Office of Foreign Assets Control).

Because of their complexity, midsize banks and large banks[15] remain delegated when they become 4- and 5-rated. Staff from the OCC's Midsize Bank Supervision Division and Large Bank Supervision Department may collaborate with the Special Supervision Division on problem banks in their portfolios, but the Midsize Bank Supervision Division and Large Bank Supervision Department remain the designated supervisory offices. The Special Supervision Division's directors and problem bank specialists (PBS) also collaborate with subject matter experts and OCC legal counsel and, in many cases, OCC senior management and other federal banking agencies.

Examiners must document any change in supervisory office in the appropriate supervisory information system and communicate it to the bank. Once the Special Supervision Division assumes responsibility, it directs the supervision of the problem bank, with assigned field examiners working under a PBS's direction. Problem bank supervision is time-intensive. Assistant deputy comptrollers, examiners-in-charge (EIC), and examiners should recognize these time requirements when planning supervisory activities,[16] diverting non-critical responsibilities to other staff. Ongoing supervision includes routine liquidity monitoring, following up on enforcement action compliance, and regularly reviewing asset quality, earnings, and capital. Examiners assigned to problem banks are responsible for strategy development, off-site reviews, and input into developing enforcement actions.

[15] Midsize banks are those supervised by the OCC's Midsize Bank Supervision Division. Large banks are those supervised by the OCC's Large Bank Supervision Department.

[16] Supervisory activities include the examination and supervision activities throughout a bank's supervisory cycle.

Problem Bank Identification

This section of the booklet discusses red flags that can indicate emerging risks, potential deficiencies, or adverse conditions that may result in a bank becoming a problem bank.[17] Red flags take many forms and are often present before a bank's condition deteriorates. Examiners should consider the bank's specific circumstances and discuss red flags with bank management when determining whether a concern exists.

When examiners identify red flags, it may be appropriate to modify the supervisory strategy to assess the circumstances further. Examiners can recommend modifying the supervisory strategy to include conducting a target examination, accelerating the timing of an examination, or expanding the scope of a supervisory activity.

After concluding that there are deficiencies, examiners should document and communicate the deficiencies and commitments for corrective action in supervisory correspondence. When examiners identify adverse conditions, they should identify the root causes and, as appropriate, communicate the OCC's concern with the practices that caused the conditions. Examiners should identify the parties responsible for deficiencies and attribute responsibilities for deficiencies and corrective actions to specific individuals when possible. Corrective actions are likely to be most successful and least costly while a bank's condition is sound and management's attention is not divided among multiple deficiencies. Deteriorating economic conditions, when coupled with a bank's failure to address previously identified weaknesses, warrant stronger supervisory action. If the bank does not address previously identified deficiencies satisfactorily, examiners should assess the appropriateness of corrective actions, evaluate management or the board's commitment, and proceed with escalated action when warranted, consistent with the severity of the deficiencies.[18]

Board and Management Oversight Weaknesses

Although economic conditions often correlate with a bank's condition, the performance of a bank's board and management generally has greater influence on whether a bank succeeds or fails.[19] Many bank failures can be attributed to poor board and management decisions and weak board and management oversight. Board and management decisions can have far-reaching implications for a bank's condition. Sound board and management oversight is an important factor in mitigating the impact of adverse economic events on the bank. Examiners

[17] Deficient practices and adverse conditions can include unsafe or unsound practices or conditions. Refer to footnote 11 for the definition of "unsafe or unsound practice."

[18] For more information about addressing deficiencies, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

[19] Refer to "Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks," OCC (June 1988).

should focus on indicators of board and management oversight weaknesses, such as the following.[20]

Failure to take timely and effective corrective action: Implementing corrective actions that do not address a deficiency's root cause or failure to correct deficiencies in a timely manner can contribute to deterioration of the bank's condition. Examiners should focus on corrective actions that are past due when following up on concerns in matters requiring attention (MRA), violations of laws or regulations, enforcement actions, independent risk management reviews (e.g., credit risk review, compliance review), or audit findings. Additionally, examiners should pay particular attention to the root causes of repeat concerns (i.e., concerns that were previously corrected, but have reoccurred).

Dominant influence from individual owners, managers, or directors: Aggressive or dominant individuals in key positions at a bank can circumvent or prevent adequate separation of duties, controls, and independent review. Individuals that exert undue influence without credible challenge from auditors, independent risk management, directors, or senior management pose risk to a bank's safety and soundness. A board that is subject to excessive influence may not be able to effectively fulfill its fiduciary and oversight responsibilities.[21] Examiners should assess whether the board comprises internal and external directors, exercises independent judgment, and adopts conflict-of-interest or independence standards that promote director accountability.

Passive or uninformed board of directors: A strong, independent, and knowledgeable board contributes to a bank's long-term health. During difficult economic times, a strong board can increase the likelihood of a bank's survival. The board is responsible for overseeing management, providing organizational leadership, establishing core corporate values, and holding management accountable for meeting strategic objectives consistent with the bank's risk appetite. Directors should remain current on key banking activities, particularly new ones, to be able to make prudent decisions and provide credible challenge to management. Examiners should assess board reports and board minutes for accuracy, completeness, and timeliness, and assess whether board minutes reflect critical challenge of senior management. Examiners should also assess the composition of the board of directors including experience, turnover, diversity of opinion, and the effectiveness of training and awareness programs for directors.

Inadequate talent and experience of senior management: Senior management, particularly the chief executive officer or president, has a major effect on the bank's success or failure. Therefore, examiners should review senior management's experience, particularly in managing under adverse conditions. Examiners should assess senior management's ability and willingness to lead and manage the bank, especially in banks engaging in new, modified,

[20] For more information regarding management and board oversight, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook*.

[21] For more information about directors' fiduciary duties, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook*.

or expanded products or services (collectively, new activities) or expanding through growth, mergers, or acquisitions.

Increasing or ongoing noncompliance with laws, regulations, or bank policies: Noncompliance can be a symptom of risk management and internal control weaknesses, including compliance management system weaknesses. Compliance management system weaknesses can lead to losses, fines, civil money penalties (CMP), payment of damages, the voiding of contracts, ~~and increased reputation risk~~.[22] Examiners should assess trends in violations and policy exceptions, significant litigation, and customer complaints. Often, compliance management system weaknesses are accompanied by other issues, such as insider abuse, fraud, audit program weaknesses, or inadequate management and board reports.

Insufficient planning and response to changes: Such insufficiencies can expose a bank to strategic and other risks. Examiners should be alert for a lack of long-term planning, conflicting organizational goals, inadequate resources to achieve goals, and inadequate implementation plans. For banks pursuing new activities, examiners should review bank management's analysis of the risks of such activities. Examiners should discuss with bank management the bank's plans and management's alternatives if plans do not materialize.[23]

Audit program weaknesses: Weaknesses within an audit program, such as lack of auditor competence or independence, inadequate scope or frequency of audits, and insufficient testing, can result in the bank not identifying weaknesses or significant risks. Failure to address audit-identified deficiencies is also a weakness that can result in negative consequences for the bank. Failure to identify or remediate weaknesses can result in a bank becoming a problem bank.

Fraud, Insider Abuse, and Insider Misconduct

Insider abuse and fraud have contributed to many bank failures. Such conduct can affect a bank's condition and undermine public confidence even in banks that are otherwise in sound condition. Fraud can be internal or external and can occur throughout a bank's operations, including third-party relationships. Fraud is typically accompanied by weak oversight or weak internal controls. Some examples of fraud, abuse, or misconduct include

- forgery or alteration of documents.
- misapplication of funds or assets, including fraudulent funds transfers.
- impropriety in reporting financial transactions.
- profiting from insider knowledge.
- accepting inappropriate personal gifts from bank customers or third parties.
- embezzlement.
- check kiting.

[22] For more information about compliance management systems, refer to the "Corporate and Risk Governance" and "Compliance Management Systems" booklets of the *Comptroller's Handbook*.

[23] For more information, refer to OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles."

- inappropriate or excessive compensation, including salaries, fees, and benefits.
- unauthorized access to critical systems.
- nominee loans[24] or similar transactions that are constructed to circumvent laws, regulations, or bank policies or limits.
- intentionally masking past-due loans by capitalizing interest for borrowers that have no ability to pay.
- release of collateral for insiders or affiliates contrary to bank policy.

Although insiders typically conceal abuse and fraud from routine scrutiny, there usually are red flags that aid detection. Examiners should be aware of bank transactions with insiders and their related interests that could indicate preferential treatment, a breach of fiduciary duty, personal gain, or violations of insider-related laws and regulations, including Regulation O.[25] Examiners should review transactions with related organizations that could present conflicts of interest or violations of laws or regulations.[26] Some examples of activities regarding insiders or related organizations that could warrant expanded review include[27]

- third-party relationships with entities or individuals associated with bank insiders.
- loans to insiders or their related interests or business associates.
- correspondent account activities.
- dominant officer with control over the bank or a critical operational area.
- ownership or control vested in a small group that has a dominant influence on decision making.
- internal audit restrictions or unusual reporting relationships (e.g., the internal auditor not reporting directly to the board or audit committee).
- unusual or lavish fixed assets (e.g., aircraft or artwork).
- management attempts to unduly influence examination or audit findings.
- frequent change of auditors or high turnover in the audit department.
- delay tactics, alteration, or withholding of records.
- difficulty determining who is responsible for specific bank activities.

[24] A "nominee loan" is one in which the borrower named in the loan documents is not the real party in interest, i.e., the party that receives the use or benefit of the loan proceeds. Refer to "The Detection, Investigation and Prevention of Insider Loan Fraud: A White Paper," from the Federal Financial Institutions Examination Council (May 2003).

[25] Refer to 12 CFR 31.2, "Insider Lending Restrictions and Reporting Requirements," and 12 CFR 215, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation O)." Also refer to *OTS Examination Handbook* section 380, "Transactions With Affiliates and Insiders" (FSAs) and section 730, "Related Organizations" (FSAs).

[26] For more information about transactions with related organizations, refer to the "Related Organizations" booklet of the *Comptroller's Handbook* (national banks), *OTS Examination Handbook* section 380, "Transactions With Affiliates and Insiders" (FSAs), and *OTS Examination Handbook* section 730, "Related Organizations" (FSAs).

[27] For more information about insider activities, refer to the "Insider Activities" booklet of the *Comptroller's Handbook.*

- overly complex organizational structure, managerial lines of authority, or contractual arrangements without apparent business purpose.
- inaccurate, inadequate, or incomplete board reports.
- discontinuation of key management or board reports.
- a key employee or officer who never takes a vacation, or inadequate bank enforcement of vacation policies.
- high salaries, bonuses, and fees relative to the bank's size, business activities, complexity, and condition and management's competency.[28]
- unusual fee payments, including payments
  - when there is no benefit or legitimate business purpose (e.g., personal legal fees).
  - for services not yet received (e.g., an advance to an insider's company for future work on other real estate owned properties).
  - established solely to meet a shareholder or insider's need for funds (e.g., a consulting fee to a director or relative of an insider experiencing financial difficulties).
- extensions of credit that are granted on more favorable terms than for similar borrowers.[29]
- insider asset sales or purchases that do not reflect market terms.[30]
- higher rates paid on deposits to insiders or their related interests.[31]
- unexplained or irregular transactions between insiders and bank customers or affiliates.[32]
- refusal of bank officers to provide examiners access to bank books, records, or personnel.[33]
- efforts by bank officers to obstruct access to relevant information.[34]

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[28] For more information regarding compensation, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook* and 12 CFR 30, appendix A.II.I, "Compensation, Fees and Benefits," and A.III, "Prohibition on Compensation that Constitutes an Unsafe and Unsound Practice."

[29] Refer to 12 CFR 31.2, "Insider Lending Restrictions and Reporting Requirements," and 12 CFR 215, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation O)."

[30] Refer to 12 USC 1828(z), "General Prohibition on Sale of Assets," for restrictions on purchasing assets from or selling assets to executive officers, directors, or principal shareholders, or their related interests. Banks' purchases of assets from, or sales of assets to, insiders who are outside the scope of 12 USC 1828(z) should be consistent with safe and sound banking practices.

[31] 12 USC 376, "Preferential Interest Payments," prohibits the payment of preferential interest on deposits to any director, officer, attorney, or employee of a national bank. FSAs are not subject to this same statutory prohibition. Depending on the circumstances, the payment of preferential interest to a director or officer could be an unsafe or unsound practice or a breach of fiduciary duty.

[32] Refer to 12 CFR 223, "Transactions Between Member Banks and Their Affiliates (Regulation W)," for requirements regarding affiliate transactions. Refer also to the "Related Organizations" booklet of the *Comptroller's Handbook* (national banks), *OTS Examination Handbook* section 730, "Related Organizations" (FSAs), and *OTS Examination Handbook* section 380, "Transactions With Affiliates and Insiders."

[33] For more information, refer to the "Restricted Access to Bank Staff and Documents" section of this booklet and the "Bank Supervision Process" booklet of the *Comptroller's Handbook*, appendix B, "Examiner Access to Bank Books and Records."

[34] Ibid.

- significant travel or entertainment expenses that do not align with the bank's profile or business activities, particularly when coupled with poorly maintained records of the business purpose of those expenses.

Because of the nature of the OCC's examination work, one of the most common types of fraud examiners uncover is loan fraud. Loan fraud can take many forms, such as loans to fictitious parties or nominee loans, loans granted with false credit and financial information, or self-dealing (e.g., bank employee making or increasing a loan to himself or herself). Loan fraud can also involve kickbacks and diversion of funds. As examiners perform credit reviews, they should focus on red flags such as the following that could indicate loan fraud:

- Large volumes of loans replaced rapidly in a portfolio.
- Low-quality assets sold to affiliated and unaffiliated banks.[35]
- Loan growth that does not seem plausible based on economic conditions, the bank's underwriting criteria, or the bank's operational infrastructure.
- Missing loan file documentation.
- Lack of support for draw requests.
- Inflated collateral values in real estate appraisals or evaluations.
- Above-market appraisal fees.
- Unexplained cost overruns on construction loans.
- Restructuring past-due loans and capitalizing interest when borrowers lack the ability to pay or collateral values have deteriorated.
- Rapid sales and purchases of land by a borrower within a short period.
- Numerous loan increases, renewals, or extensions without justification.
- Unexplained cash flow discrepancies.
- Unusually low past-due or charge-off rates when considering the risk characteristics of the portfolio and economic conditions.
- An unusual number of loans in the examiners' loan sample paid off, particularly within a short period.
- Significant internal control weaknesses identified by credit risk review or credit-related audits, including poor user access controls over loan origination systems.
- Liberal underwriting.

Consistent with risk-based supervision, examiners should assess a bank's fraud risk management.[36] Internal and external audit report conclusions on internal controls are helpful sources for examiners to review when assessing a bank's fraud risk profile. Examiners perform a risk-based review of the bank's audit function and internal controls every supervisory cycle. Examiners should assess the bank's audit function by reviewing audit's

[35] Purchasing a low-quality asset from an affiliate is generally impermissible. Refer to 12 CFR 223.15, "May a Member Bank Purchase a Low-Quality Asset From an Affiliate?"

[36] Refer to OCC Bulletin 2019-37, "Operational Risk: Fraud Risk Management Principles." Refer also to *OTS Examination Handbook* section 360, "Fraud and Insider Abuse" (FSAs). While this handbook section does not apply to the OCC's supervision of national banks, it includes general information about fraud that examiners may find useful when examining any type of bank.

conclusions (i.e., audit reports) and work papers.[37] If the audit work paper review identifies significant discrepancies or weaknesses in the audit program or the control environment, examiners should expand the examination of those areas and affected operational or functional business areas. Examiners may use internal control questionnaires in conjunction with the expanded procedures. If concerns remain, examiners should consider performing verification procedures.

If insider abuse or fraud is detected or suspected, examiners should immediately advise the supervisory office and OCC legal counsel. The supervisory office should determine whether an examiner with fraud expertise (e.g., a Certified Fraud Examiner) should participate in the examination. Depending on the conclusions, supervisory actions could include communicating concerns in MRAs, citing violations of laws or regulations, taking enforcement actions (including CMPs against the bank or its institution-affiliated parties (IAP)),[38] or making a referral to another agency. It may be necessary to open an order of investigation to subpoena documents and take sworn statements.[39]

Restricted Access to Bank Staff and Documents

Pursuant to 12 USC 481 (national banks) and 12 USC 1464(d)(1)(B) (FSAs), OCC examiners are authorized to make a thorough examination of a bank, which includes prompt and unrestricted access to the bank's books and records. The OCC's authority applies to all supervisory activities and is not limited to supervisory activities of a specific length, scope, or type. Also included within the scope of the OCC's authority is that OCC examiners must be able to communicate freely with bank personnel.

Pursuant to 12 USC 1867(c) (national banks and FSAs) and 12 USC 1464(d)(7)(D) (FSAs), the OCC has the authority to examine functions or operations performed on behalf of a bank by a third party. Examiners also are entitled to access the third party's books and records relevant to such services provided by a third party to the same extent as if the bank were performing the services itself.[40]

A denial of access to a bank's books, records, or personnel is a red flag. Although such a situation may be a misunderstanding between examiners and bank management, it also may indicate that management is concealing evidence of deficiencies or attempting to prevent examiners from discovering the bank's true financial condition.

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[37] For more information about reviewing audit programs, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook.*

[38] Refer to 12 USC 1813(u), "Institution-Affiliated Party," for the definition of IAP.

[39] Refer to the "Supervisory Actions" section of the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

[40] For more information, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*, appendix B, "Examiner Access to Bank Books and Records."

The following are examples of red flags that could indicate possible examination obstruction:

- Delaying responses
- Screening information before providing it to examiners
- Restricting access to relevant books or records maintained by third parties
- Altering books and records
- Removing or concealing books and records
- Deleting books and records
- Attacking examiners' credibility
- Unusual or repeat claims of system limitations or manual workarounds in providing information

Examiners who encounter suspected examination obstruction should contact their supervisory office and appropriate OCC legal counsel. In many cases, the situation may be a misunderstanding that can be resolved. A bank's failure to provide timely examiner access, or efforts by the board or management to impede the bank staff's ability to provide such access, could result in enforcement action. Furthermore, examination obstruction may subject individuals to criminal prosecution.[41]

Risk Management Weaknesses

The bank's risk management system comprises the bank's policies, processes, personnel, and control systems. A sound risk management system identifies, measures, monitors, and controls risks.[42] Banks with well-developed risk management systems are more resilient to economic cycles.

Risk management weaknesses can exist in any area of the bank. Examiners should assess the quality of policies, processes, personnel, and control systems within their assigned areas. Some examples of risk management deficiencies include

- inadequate policies, or policies that are not well understood by bank management or staff.
- scope or frequency of audits, credit risk reviews, or other independent reviews that are not commensurate with the bank's risk profile.
- an internal audit program that is not independent or is supported by staff with insufficient expertise.
- risk measurement systems or models (e.g., interest rate risk [IRR] models) that are too simple for the bank's size or the nature of the bank's on- and off-balance-sheet exposures.
- inadequate planning for emerging technology needs.

[41] Refer to 18 USC 1517, "Obstructing Examination of Financial Institution."

[42] For more information about risk management systems, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook*.

- inadequate due diligence for acquisitions, new activities, or critical third parties.[43]
- risk management systems that do not evolve to keep pace with the bank's growth, increasing complexity, or changes in the bank's products or services.

When risk management weaknesses exist, examiners should take appropriate supervisory or enforcement actions. Supervisory responses should grow in severity when the deficiencies are coupled with other red flags, such as excessive concentrations, rapid growth, or deteriorating conditions. If significant risk management deficiencies accompany increasing or high levels of risk or a deterioration in the bank's financial condition, the OCC may escalate supervisory and enforcement activities until the situation is resolved. Examiner communications and expectations should be clear, specific, and directly relevant to the bank's deficiencies.

Concentration Risk Management Weaknesses

Concentration risk management weaknesses can have a substantial negative effect on a bank's condition. Concentrations of credit played a significant role in bank failures during past financial crises. Once excessive concentration risk is embedded in a bank's balance sheet, the bank may have limited options to control that risk, particularly in an economic downturn. Examiners should determine whether bank management and the board understand and effectively manage the risks associated with significant concentrations. Weak concentration risk management practices and uncontrolled growth can lead to significant concentrations, including geographic concentrations. Failure to engage in adequate concentration risk management, which includes understanding key risks and being able to manage those risks, can be considered an unsafe or unsound practice,[44] result in a strong supervisory response, and contribute to rapid deterioration of the bank's condition.

The highest level of concentration risk historically has been in the loan portfolio; however, one unique aspect to the 2008 financial crisis was the correlated or layered risk found within other segments of banks' balance sheets. Boards often failed to place reasonable limits on the volume of specific types of lending, most notably for the commercial real estate and construction and development loan portfolios.[45] Further, many banks layered concentration risk with credit risk in the investment portfolio, high-risk retail lending, and risk from reliance on volatile funding sources, such as brokered deposits, to fuel growth. Risk layering was compounded when, because of a bank's deteriorating condition, certain funding was no longer permissible or available at a reasonable cost.

[43] For more information, refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"; OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29"; and OCC Bulletin 2017-43.

[44] Refer to footnote 11 for the definition of "unsafe or unsound practice."

[45] For more information about commercial real estate concentrations, refer to OCC Bulletin 2006-46, "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices: Interagency Guidance on CRE Concentration Risk Management."

Examiners should review and assess a bank's concentration levels and risk management practices considering the significant and rapid impact concentrations can have on a bank's condition. Examiners should determine whether banks' concentration policies and processes align with the bank's business strategies and reasonable growth plans.[46]

Uncontrolled, Rapid, or Significant Growth

Uncontrolled, rapid, or significant growth is a red flag for potential problems in banks. Banks experiencing such growth should receive additional supervisory review commensurate with the nature and extent of the growth. Uncontrolled, rapid, or significant growth can be a sign of risk management weaknesses and can increase a bank's risk exposure, stretch the expertise of bank management, and strain the bank's resources, which, in turn, can lead to numerous and sometimes sudden bank failures as sectoral economic conditions change (e.g., in energy or real estate). Even when banks are in sound condition, examiners should evaluate growth and a bank's growth strategies for vulnerability to management gaps and economic downturns. Examiners should determine whether the bank's risk management systems have evolved to keep pace with growth. When assessing a bank's growth plans, examiners should consider whether bank management has appropriately planned for any changes in risk management systems to keep pace with the growth.[47] Uncontrolled, rapid, or significant growth can exacerbate or accelerate problems at a bank with existing risk management weaknesses. In addition to the risks directly associated with new activities, excessive growth may divert the board and management from managing risks associated with the bank's existing activities.

Examiners should use analytical tools and trend analysis when analyzing a bank's growth. Banks with total loans and leases that increased notably from prior quarters may warrant closer scrutiny. Examiners should also review changes in other major balance sheet or income statement categories from previous quarters. Additionally, some of the most meaningful information about bank growth and projections is in bank budgets, operating plans, board reports, and strategic plans. Measures to consider when assessing growth include

- asset growth compared with capital growth.
- annualized asset and loan growth, in both the aggregate and within loan segments.
- annualized changes in
  - relevant ratios, including return on average assets and net interest margin.
  - other real estate owned (OREO).
  - the allowance for loan and lease losses (ALLL) or allowance for credit losses (ACL)[48] balance.

[46] For more information about the OCC's supervision of concentrations of credit, refer to the "Concentrations of Credit" booklet of the *Comptroller's Handbook*.

[47] For more information about strategic and operational planning and new activities, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook* and OCC Bulletin 2017-43.

[48] This booklet uses the term "credit loss allowance" to refer to a bank's ALLL or ACL.

  - risk-based capital and leverage capital ratios.
- changes in the bank's liability structure, including increasing reliance on volatile funding sources.
- quarterly and annualized changes in off-balance-sheet items.
- growth rates in the bank's strategic plan and budget.

Excessive growth, as measured against local, regional, and national economic indicators, is often a precursor to asset quality problems. When assessing whether growth is excessive, examiners consider the growth compared with the bank's capital base, financial condition, risk profile, and risk management systems. Excessive growth can strain banks' underwriting and risk selection standards, as well as management's capacity, existing control systems, and credit administration. Excessive growth can reflect fundamental changes in bank practices warranting additional supervisory attention. Examiners should determine how the bank has grown rapidly or significantly. Changes in bank practices that often accompany excessive growth include easing underwriting or pricing standards, introducing loan products, increasing customer or product risk tolerances, introducing unbalanced compensation programs,[49] and expanding or changing lending areas or sources of loans.

Consistent with the "Interagency Guidelines Establishing Standards for Safety and Soundness," a bank's asset growth should be prudent and consider[50]

- the source, volatility, and use of funds that support asset growth.
- any increase in credit risk or interest rate risk as a result of growth.
- the effect of growth on the bank's capital.

Measures alone are insufficient to provide a conclusion on the quantity of risk, and do not consider the quality of risk management. Examiners should consider the following in addition to measures assessing the quantity of growth:

- **Risk management:** Examiners should assess bank management's plans to determine the adequacy of the bank's risk management system and system of internal controls, particularly in the growth area. Banks' risk management systems should evolve, as necessary, and be sufficiently robust to keep pace with additional complexities of planned activities.[51] Examiners should consider whether the bank's strategic plan or budget includes sufficient planning and resources to maintain an adequate risk management system and control environment.
- **Underwriting:** Examiners should assess loosening loan underwriting standards, revisions to customer or product risk tolerances, or changes to lending areas or sources of loans for

[49] For more information about compensation practices, including incentive compensation, refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook* and OCC Bulletin 2010-24, "Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies."

[50] Refer to 12 CFR 30, appendix A, II.F., "Asset Growth."

[51] Refer to OCC Bulletin 2017-43.

their contribution to asset growth and to determine if such changes indicate increasing risk.

- **Staffing:** Examiners should assess whether the bank has sufficient expertise to oversee the growth and consider whether staffing is keeping pace with the growth. A bank's due diligence for new activities should include determining the expertise needed to effectively manage the new activities, including the possible need to hire or otherwise acquire additional expertise.[52]
- **Funding:** Examiners should consider how funds management and liquidity practices contribute to the growth. Examiners should focus on banks' use of new or more volatile funding sources, such as asset securitization or brokered deposits, to finance growth.
- **Credit loss allowance:** Examiners should assess the bank's projections for continued credit loss allowance adequacy given the changes in the size of the loan portfolio and changes in underwriting.
- **Capital:** Examiners should assess capital relative to a bank's changing risk profile and rapid growth to determine if capital levels remain sufficient.

Examiners may need to recommend adjusting the supervisory strategy in light of actual or planned growth. Examiners may decide to expand the scope of periodic monitoring activities, conduct a target examination, accelerate the timing of a planned supervisory activity, or expand the scope of a planned or in-process supervisory activity. Depending on the circumstances, a supervisory activity's scope may need to be expanded to include a more focused review of the area experiencing growth and an expanded assessment of the bank's risk management system.

When examining a bank experiencing rapid or significant growth, examiners should consider adjusting the examination scope or supervisory strategy if one or more of the following conditions exist:

- Growth is significantly higher than the bank's budget projections or strategic plan.
- The bank's risk profile is inconsistent with the risk appetite.
- The bank's underwriting and risk selection standards have relaxed.
- The bank changes risk limits to accommodate the increasing level of risk.
- There is a large or increasing volume of exceptions to the bank's loan policies, including underwriting and documentation exceptions.
- The bank's risk management practices have not evolved despite growth or changes in products or services.
- Capital ratios are declining rapidly.
- Funding sources are volatile, short-term, or rate- or credit-sensitive.
- New activities are pursued with limited expertise or inadequate controls.[53]
- Growth results from brokered or agent transactions.

[52] Ibid.

[53] Ibid.

If examiners identify weaknesses in a bank's practices regarding growth (e.g., strategic planning, risk management, or internal control weaknesses), they should determine whether the weaknesses meet the definition of a deficient practice. In some cases, an enforcement action may be appropriate, particularly if growth is not accompanied by an appropriate control environment and management oversight. For example, an enforcement action could be appropriate if the volume or nature of growth is already affecting the bank's condition. The use of safety and soundness plans or orders can be an effective action to address a bank's excessive growth, especially if the bank has satisfactory capital. The PCA framework imposes mandatory restrictions on the growth of assets for banks within the undercapitalized, significantly undercapitalized, and critically undercapitalized capital categories.[54]

Asset Quality Deterioration

Historically, the most common adverse condition shared by problem banks was asset quality deterioration. Whether caused by economic factors, excessive concentrations, weak management, ineffective board or management oversight, anxiety for earnings, insider abuse, or other factors, less-than-satisfactory asset quality is a factor in nearly all problem banks. The following are indicators of potential asset quality deterioration:

- A credit loss allowance balance that is not directionally consistent with trends in loan growth or performance.
- Significant changes in the credit loss allowance methodology or balance.
- Increasing levels of past-due and nonaccrual loans as a percentage of loans, either in aggregate or within loan types.
- Increasing levels of OREO.
- Increasing levels of accrued interest receivable as a percentage of loans, particularly when compared with historical bank and peer levels.
- Deterioration in economic conditions.
- High growth rates in overall loans or individual loan types, particularly loans with high-risk characteristics, policy exceptions, or underwriting weaknesses.
- Extending repayment terms for loans.
- Increase in average risk ratings or increase in classified, special mention, or watch list assets.
- Large or significantly increasing volume of loan policy and underwriting exceptions.
- Large volume of loans with underwriting weaknesses.[55]
- Excessive credit or collateral documentation weaknesses.
- Inadequate or inaccurate management or board reports.
- Increased credit-related legal expenses.
- Significant changes in number or experience of lending or credit administration staff.
- Delinquent or inadequate credit risk reviews.

[54] For more information, refer to the "Supervisory Actions" and "Prompt Corrective Action" sections of this booklet.

[55] Refer to the "Rating Credit Risk" booklet of the *Comptroller's Handbook* for examples of structural weakness elements.

- Inordinately high volume of out-of-area lending.
- Large or increasing volume of unsecured lending.
- Increasing or excessive concentrations of credit.

The existence of one or more of these indicators should prompt the examiner or supervisory office to consider modifying the bank's supervisory strategy to assess the risk exposure and determine whether deficiencies exist and corrective actions are necessary.

Significant Credit Loss Allowance and Asset Valuation Adjustment Issues

Some banks in stressed financial condition inappropriately postpone recognizing problem assets by deferring charge-offs and credit loss allowance provisions. Examiners should be alert to symptoms of such tactics. The following red flags could indicate a need to closely review the adequacy of the credit loss allowance and its methodology:[56]

- The rate of growth in the credit loss allowance is significantly different than the rate of growth in total loans. A disproportionately large rate of growth in the credit loss allowance might signal a significant increase in problem loans. Conversely, if the rate of loan growth significantly exceeds that of the credit loss allowance, it might signal potential deficiencies in the credit loss allowance methodology, which may also be a red flag that the bank is manipulating earnings.
- The percentage of nonperforming or classified loans to total loans is increasing at a greater rate than the credit loss allowance.
- Credit loss allowance coverage of net loan losses is low.
- Documentation of the credit loss allowance methodology is inadequate, such as inappropriate consideration of adjustments for historical loss experience. Examples of credit loss allowance methodology weaknesses include the following:
  - A methodology that places an overreliance on credit loss experience during a period of economic growth generally does not result in realistic estimates of credit losses during a period of economic downturn.
  - In a problem bank, management could inflate collateral values to avoid loss recognition. In practice, management could postpone recognition that the value of the collateral has declined.

The red flags suggest the potential for credit loss allowance deficiencies, but examiners should view these red flags in conjunction with other factors, such as merger and acquisition activity, the quality of management and board oversight, quality of credit risk management, risk rating accuracy and timeliness, the bank's propensity to manage earnings, and historical

[56] For banks that have not implemented the current expected credit losses (CECL) methodology, refer to OCC Bulletin 2006-47, "Allowance for Loan and Lease Losses (ALLL): Guidance and Frequently Asked Questions (FAQs) on the ALLL," and the "Allowance for Loan and Lease Losses" booklet of the *Comptroller's Handbook*. For banks that have implemented CECL, refer to the "Allowances for Credit Losses" booklet of the *Comptroller's Handbook* and OCC Bulletin 2020-49, "Current Expected Credit Losses: Final Interagency Policy Statement on Allowances for Credit Losses." For all banks, refer to the *Bank Accounting Advisory Series.*

credit loss allowance adequacy. Credit loss and recovery experience can vary significantly during a business cycle.

Examiners should assess whether valuations of problem assets are reasonable. An effective method of testing collateral valuation practices is to review appraisals or other valuations on several large problem loans and OREO holdings. Weaknesses in valuation practices are often apparent in a sample of collateral-dependent problem assets.[57] Examiners should consider testing a sample that includes appropriate representation of the bank's problem loans. For example, a representative sample generally includes loans of various sizes.[58]

Significant Off-Balance-Sheet Exposure

Although off-balance-sheet exposures have not historically been a primary cause of bank failures, these exposures warrant examiner attention. Weak internal controls over accounting and income recognition could result in overstated earnings. With bank securitization activity and the proliferation of capital markets products, more credit risk is shifting to off-balance-sheet transactions. Traditionally, off-balance-sheet credit risk has come primarily from unfunded loan commitments and letters of credit. The credit risk in these products is typically straightforward. The credit risk in capital markets products, such as asset securitizations and derivatives, is more difficult to quantify because of the need to assign a credit risk equivalent. Examiners should include an assessment of off-balance-sheet and other indirect exposures when assessing a bank's risk profile.[59]

Examiners reviewing off-balance-sheet activities should be alert to potential increases in a bank's risk exposure. Examples of some red flags regarding off-balance-sheet activities include

- participation in markets without appropriate management or staff knowledge or expertise.
- large levels of off-balance-sheet activity relative to the bank's size and risk profile.
- substantial exposure to a counterparty whose ability to meet its obligations is uncertain.
- significant residual values or recourse obligations related to securitization transactions.
- accounting errors for off-balance-sheet exposures.
- no established limits for off-balance-sheet activities.
- incorrect risk-based capital treatment for off-balance-sheet exposures.
- inadequate control systems (e.g., audit, independent risk management).

[57] Refer to 12 CFR 34, subpart C, "Appraisals"; OCC Bulletin 2010-42, "Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines"; OCC Bulletin 2018-39, "Appraisals and Evaluations of Real Estate: Frequently Asked Questions"; and booklets in the "Asset Quality" series of the *Comptroller's Handbook.*

[58] For more information about judgmental and statistical sampling, refer to the "Sampling Methodologies" booklet of the *Comptroller's Handbook*.

[59] Refer to the "Risk Management of Financial Derivatives" (national banks and FSAs), "Interest Rate Risk" (national banks and FSAs), and "Asset Securitization" (national banks) booklets of the *Comptroller's Handbook* and *OTS Examination Handbook* section 221, "Asset-Backed Securitization" (FSAs). Refer also to OCC Bulletin 1999-46, "Interagency Guidance on Asset Securitization Activities: Asset Securitization."

Asset Securitization

Asset securitization involves transferring on-balance-sheet assets to a third party, typically a trust, partnership, or other special-purpose vehicle, which then issues asset-backed securities to investors. The repayment of the asset-backed securities is supported by the cash flows of the transferred assets. Asset securitization can provide benefits to banks including allocating capital more efficiently, accessing diverse and cost-effective funding sources, and managing business risks. It also can improve profitability. If used improperly or managed ineffectively, asset securitization can materially increase risk to the bank.

Accounting Standards Codification (ASC) Topic 860, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," governs the accounting treatment for asset transfers in a securitization transaction. If a securitization transaction meets ASC Topic 860 criteria, the seller must recognize a gain or loss on the sale on the date of the transaction (known as "gain on sale accounting"). Future expected cash flow streams from securitized assets are recognized by establishing residual assets and servicing assets or liabilities.

The valuation methods and assumptions used to value the residual assets and servicing assets warrant supervisory attention. Actual performance of the underlying assets can differ from the original estimates, leading to write-downs and capital impairment. The advent of ASC Topic 860 increases the potential for issuers to generate unrealized losses or mask actual losses through flawed assumptions, such as inaccurate prepayment rates and unsupported discount rates. Improper valuation practices also can lead to significant write-downs of the residual asset.

Asset securitization transactions may explicitly or implicitly provide investors recourse to the bank that can adversely affect capital. Therefore, examiners should be aware of the risk-based capital rules for those transactions.

It is important for banks involved in asset securitization transactions to have appropriate risk management to identify, measure, monitor, and control associated risk. Examiners should assess how management confirms that valuation methods and key assumptions used to value the residual assets and servicing assets and liabilities are reasonable and well supported.

Derivatives

Financial derivatives are defined broadly as instruments that primarily derive their value from the performance of underlying interest rates, foreign exchange rates, equity prices, or commodity prices. Examples include futures, forwards, swaps, options, structured debt obligations, structured deposits, and various combinations thereof. Derivatives can expose a bank to all risk types. The risk of derivatives is a function of the timing and variability of cash flows.

Per ASC Topic 815, "Accounting for Derivative Instruments and Hedging Activities," banks are required to record derivatives (as defined in the accounting standard) on their balance

sheets as assets or liabilities at fair value. The financial statement impact for changes in the fair value of a derivative (i.e., gains and losses) generally depends on (1) whether the derivative has been designated and qualifies as part of a hedging relationship and (2) the reason for holding the derivative. The accounting treatment prescribed in ASC Topic 815 can affect a bank's leverage and risk-based capital ratios. Instructions for Preparation of Consolidated Reports of Condition and Income (call report instructions) discuss in detail ASC Topic 815 and the risk-based capital treatment for derivatives.[60]

Strained Liquidity

Examiners should understand a bank's funding structure and funds management strategies, risks associated with the behaviors and sensitivities of funds providers, and relevant changes in the technological, regulatory, and economic environment as well as the bank's local market before drawing conclusions on the bank's liquidity position. Retail and wholesale funds providers have different credit and interest rate sensitivities and react differently to changes in economic and bank conditions. Retail funds providers, including insured depositors, historically have not demonstrated substantial credit- or interest rate-sensitivity; however, during the 2008 financial crisis, there were isolated instances when insured depositors panicked and withdrew funds, prompting rapid erosion in liquidity. Wholesale funds providers—typically other banks, government agencies, large commercial and industrial corporations, or wealthy individuals—often demonstrate credit- and interest rate-sensitivity.[61]

Examiners should be aware of the red flags that could signal liquidity strain and a need for additional analysis, monitoring, and supervisory action. Examples of liquidity-related red flags include

- low levels of on-hand liquidity (e.g., cash and unencumbered marketable investment securities).
- significant increases in large certificates of deposit, brokered deposits, or deposits with above-market interest rates, particularly in banks with retail funding concentrations.
- significant increases in borrowings or warehouse lines of credit. Some banks increase borrowing line usage seasonally. In these cases, examiners should determine how increases compare with historic usage.
- significant funding mismatches (e.g., funding long-term assets with short-term liabilities).
- higher costs of funds relative to the market, or significant increases in cost of funds.
- significant increases in past-due or nonaccrual loans.
- reduced borrowing-line capacity by correspondent banks or wholesale funding providers.
- counterparty requests for collateral to secure borrowing lines.
- significant declines in deposit levels.

[60] For more information, refer to 12 CFR 3, "Capital Adequacy Standards," and the "Capital and Dividends" booklet of the *Comptroller's Handbook*.

[61] For more information about liquidity risk and associated risk management practices, refer to the "Liquidity" booklet of the *Comptroller's Handbook.*

- sudden drop in bank's stock price.
- downgrades of the bank's rating by rating agencies.
- withdrawal of funds by rate- or credit-sensitive providers, such as trust managers, money managers, and public entities.
- unwillingness of counterparties and brokers to deal in off-balance-sheet or longer-dated transactions.

In addition to call report data, OCC reports and analytical tools can assist examiners in identifying liquidity red flags. Examiners should also review bank information, such as sources and uses reports, the bank's contingency funding plan, rollover risk reports, concentration reports, and liquidity trend reports. Discussions with management can provide examiners with valuable information about the risk tolerance and sensitivity of funds providers and an estimate of projected funding the bank could lose in various scenarios.

If examiners discover a potential liquidity problem, they should contact their supervisory office and, depending on the severity of the problem, consult a capital markets subject matter expert to determine the appropriate supervisory action. Because liquidity problems can worsen quickly as the risk tolerance of funds providers diminishes, timely action is critical. Examiners should be aware of situations that could adversely affect a bank's ability to obtain funding. Numerous causes can precipitate funding constraints, including deterioration in a bank's financial condition, asset quality problems, fraud, or external economic events. ~~A bank's liquidity also could be compromised because of reputation risk from real or perceived funding problems.~~ The extent of a funding problem often depends on the risk tolerance of a bank's funds providers. Funds providers generally tighten a bank's access to funding as a bank's condition deteriorates.

The following sections provide specific examples of areas that examiners should review to assess a bank's exposure to liquidity pressure.

Deposit Volatility

Deposit volatility can be a red flag of an emerging problem bank. Core deposits typically include deposits obtained through customer relationships in the bank's market. Technology enables customers to easily bank without consideration of geographic location. Examiners should evaluate depositor behavior and volatility. Deposits that exhibit the least amount of volatility can be long-standing customers that have established banking relationships. Similarly, volatility typically increases with the rate sensitivity and geographic proximity of the customer base. Examiners should assess how bank management identifies, measures, and monitors deposit volatility. Volatile deposits can be sensitive to adverse publicity ~~and reputation risk~~. Nonvolatile deposits are typically less sensitive, either as a matter of loyalty or convenience, and tend to be slower to leave the bank. Examples of characteristics that distinguish volatile from nonvolatile deposits include

- type of depositor (e.g., individual, commercial, or municipal).
- duration of the banking relationship.

- nature and depth of the banking relationship (e.g., reliance on multiple services or products such as loans, bill pay, or direct deposit).
- depositor's geographic location relative to the bank's market area.
- historical pricing associated with deposit relationship.
- changes in the average balance over time.
- effort expended to retain the relationship.
- insured versus uninsured balances in the deposit accounts.

Wholesale Funding Concentrations

A concentration in wholesale funding (e.g., borrowing lines of credit or brokered deposits) is a red flag of potential liquidity risk as a bank deteriorates. FDIC regulations[62] impose pricing and funding restrictions on banks that are, or are deemed to be, any PCA capital category other than well-capitalized.[63] Banks that are not well-capitalized may not acquire or renew brokered deposits[64] and they may have difficulty attracting or retaining deposits to replace the deposits that cannot be renewed. Consequently, if a bank relies on brokered deposits, examiners should assess the bank's strategy for shrinking the balance sheet or replacing brokered deposits with other funding sources upon maturity. FDIC regulations do not require banks to dispose of brokered deposits before the contractual maturity. Additionally, banks that are not well-capitalized are restricted to deposit pricing structures that do not exceed the higher of the national rate plus 75 basis points or 120 percent of the current yield on similar U.S. Treasury obligations of federal funds rate plus 75 basis points.[65] The FDIC posts national rate caps on its website.[66] Thus, in a competitive or rising interest rate environment, a problem bank can experience eroding deposit retention rates due to restricted pricing capacity. Pricing restrictions can also diminish the bank's ability to acquire deposits via internet deposit listing services, which can be consequential if these deposits are a contingent funding source.

Deterioration in the quality of a problem bank's loan portfolio carries consequences for wholesale funding options. Problem banks are often subject to higher collateral pledging requirements to secure borrowing lines. As the quality of the loan portfolio deteriorates, correspondent banks may become more selective about the loans they accept as collateral and

[62] Refer to 12 CFR 337.6, "Brokered Deposits."

[63] A bank subject to a formal enforcement action that contains a requirement to meet or maintain minimum capital levels is considered no better than adequately capitalized for PCA purposes, regardless of the bank's actual capital ratios. Refer to 12 USC 1831o, 12 CFR 6, and the "Prompt Corrective Action" section of this booklet.

[64] An adequately capitalized bank may apply for an FDIC waiver to accept or renew brokered deposits. For more information, refer to 12 CFR 337.6 and FDIC FIL-42-2016, "Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits."

[65] Refer to 12 CFR 337.7(a)(2). Under 12 CFR 337.7(d), banks may request to pay a rate of interest up to its local market cap rate by providing notice and evidence of the highest rate paid on a particular deposit product in the institution's local market area to the appropriate FDIC regional director.

[66] Refer to 12 CFR 337.7(b)(2).

may lower advance rates against the collateral pool. If the bank's condition continues to deteriorate, the correspondent could close the borrowing line entirely.

Concentrations in Public Funds Deposits

A bank's failure to identify, measure, control, and monitor the risks associated with concentrations of public funds deposits and to monitor compliance with collateral protection requirements may be a red flag for liquidity risk. Collateral protection requirements become particularly relevant as the bank's condition changes or deteriorates. Asset quality deterioration or financial underperformance could preclude a problem bank from acquiring or retaining public funds. Individual states can have heightened collateral protection requirements for public funds on deposit in problem banks. If the bank is unable to meet the requirements, it will be required to close the deposit account and return the funds to the depositor.

Reliance on the Federal Reserve Discount Window

The Federal Reserve discount window can help banks control liquidity risk and avoid liquidity failures. Examiners should question funding strategies in banks that place significant reliance on the discount window to meet recurring liquidity needs or liquidity needs over a prolonged period. Discount window borrowings have tight restrictions, especially for banks that are adversely rated or less than adequately capitalized under PCA standards. The discount window is available to relieve liquidity strains for individual banks as well as the banking system, but the Federal Reserve Banks are not required to lend through the discount window and may turn banks away. The discount window offers three types of credit facilities: primary, secondary, and seasonal. The primary credit facility is available to banks that are in sound financial condition; problem banks do not qualify for primary credit. The seasonal credit facility assists banks that have significant seasonality in their balance sheets. The secondary credit facility is available to banks that do not qualify for primary credit. The secondary credit facility requires banks to pledge strong collateral and generally restricts funding to overnight. Secondary credit may extend for a longer term if such credit would facilitate a timely return to reliance on market funding or an orderly resolution of a failing bank, subject to statutory requirements.[67]

Accounting

Certain accounting elections or judgments may be a red flag for a potential problem bank. Problem banks are typically under added pressure to strengthen earnings and reduce expenses to regain profitability and increase capital. To achieve those results, there may be attempts to defer loss recognition or inappropriately accelerate income recognition. For example, management might adopt overly aggressive accounting estimates, value assets improperly, or enter into unusual or related-party transactions to reduce losses or improve earnings.

[67] For more information about the discount window, refer to 12 CFR 201, "Extensions of Credit By Reserve Banks (Regulation A)."

Improper accounting practices and unwarranted changes in accounting practices can lead to a material misstatement of a bank's financial condition, including regulatory capital levels.

Banks may attempt to engage in transactions that inappropriately increase their risk-based capital ratios. Such transactions can include

- the sale of impaired or high risk-weighted assets that the bank agrees to buy back shortly after the reporting date.
- inappropriately backdating capital contributions to increase capital as of the reporting date.
- selling stock in exchange for loans.

Banks may also try to increase assets by recording notes receivable in exchange for capital stock. U.S. generally accepted accounting principles (GAAP) require that these notes be recorded as a deduction from stockholders' equity, unless they are secured by irrevocable letters of credit or other liquid assets (e.g., certificates of deposit) and are paid within a reasonably short period of time (e.g., 90 days or less). GAAP allows the notes received to be recorded as an asset rather than a capital contribution if the note is collected in cash before the bank's financial statements are issued.[68]

Bond Claims

Banks experiencing fraud and fidelity losses may have future recoveries from insurance coverage. Because bonding policies can be complex and contain numerous exceptions, it generally takes a long time to resolve such claims and receive any insurance proceeds. Due to these uncertainties, it is usually inappropriate for a bank to record a receivable for the anticipated insurance proceeds on the balance sheet before receiving a written settlement offer from the insurer. Upon receipt of a written settlement offer, the bank may record a receivable on the balance sheet along with a reduction in losses recognized in a prior period if management determines that (1) there is a high probability that the offer will be paid, and (2) the amount due to the bank can be estimated within a reasonable degree of accuracy.[69]

Service Contracts

Other transactions intended to reduce losses or improperly increase capital can include long-term service contracts to pay costs in excess of market value. These contracts are often made on the condition that the third-party purchases assets at inflated prices or makes an immediate capital investment in the bank. The third party is compensated for those transactions through higher-than-market future service fee contracts. These agreements should be accounted for in accordance with their economic substance without regard to their legal terms.[70]

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[68] Refer to the glossary entry in the "Instructions for Preparation of Consolidated Reports of Condition and Income" (call report instructions) for "Capital Contributions of Cash and Notes Receivable."

[69] Refer to *Bank Accounting Advisory Series*, Topic 6A, "Contingencies," questions 2 and 3.

[70] Refer to *Bank Accounting Advisory Series*, Topic 5C, "Miscellaneous Other Assets."

Other Assets

Assets that are not reported in major balance-sheet categories are generally reported as other assets. Although these items are listed in "other" categories, it does not mean the items are of less significance than items detailed in individual balance sheet line items. Other assets can include such activities as accrued income, prepaid and deferred expenses, and suspense accounts.

Accrued Income

Inaccurate reporting of accrued income may be a red flag that a bank is manipulating earnings to prevent loss recognition. Accrued income represents the amount of interest earned or accrued on earning assets and applicable to current or prior periods that has not yet been collected. Examples include accrued interest receivable on loans and investments. When income is accrued but not yet collected, a bank debits a receivable account and credits an applicable income account. When funds are collected, cash or an equivalent is debited, and the receivable account is credited.

Prepaid Expenses

Prepaid expenses are the costs that are paid for goods and services before the periods in which the goods or services are consumed or received. When the cost is prepaid, the payment is recorded as an asset because it represents a future benefit to the bank. In subsequent periods the asset is reduced (expensed) as the goods or services are used or rendered. At the end of each accounting period, the bank makes adjusting entries to reflect the portion of the cost that has expired during that period. The prepayment is often for a service for which the benefit is spread evenly throughout the year. As the service is provided, the prepaid expense is amortized to match the cost to the period it benefits. Examples of prepaid expenses include premiums paid for insurance, advance payments for leases or asset rentals, and retainer fees paid for legal services to be provided over a specified period. Banks may avoid expense recognition to boost earnings. For banks with high or increasing levels of prepaid expenses, examiners should evaluate prepaid expenses. Examiners' evaluations should verify that an expense has not been incurred as of the balance sheet reporting date and that any adjustments to the prepaid expense are made in a timely manner.

Suspense and Clearing Accounts

In certain circumstances, expenses are captured in a suspense or clearing account until they are transferred to the appropriate asset category on the balance sheet. The balances of suspense accounts as of the report date should not automatically be reported as "other assets" or "other liabilities." Rather, the items included in these accounts should be reviewed and material amounts should be reported in the appropriate accounts of the balance sheet and income statement.[71] Suspense accounts may be used to mask fraudulent activities, particularly when a bank has a high volume of activity flowing through these accounts.

[71] Refer to *Bank Accounting Advisory Series*, Topic 5C, "Miscellaneous Other Assets."

Activities flowing through suspense accounts should clear in a relatively short time period. Examiners should consider sampling aged items in suspense accounts.

Economic Deterioration

A correlation exists between bank performance and economic conditions in the markets served. In the 1980s, the collapse of energy prices, followed by real estate values, played a significant role in failures throughout the southwestern and the western United States. Beginning in 2008, the sharp decline in real estate values led to deterioration in many banks across the country and contributed to the failure of numerous banks.[72]

The correlation in bank performance with economic conditions does not imply causation, but examiners should be aware of the effect of local, national, and global economies on significant bank lines of business. Many banks operate several lines of business crossing multiple geographies and can be affected by a variety of factors. Examiners should understand the specific economic indicators relevant to the bank. Examples of common economic indicators are

- bankruptcies.
- business failures.
- consumer delinquency rates.
- existing home prices.
- gross domestic product.
- market prices.
- inflation rates.
- industrial vacancy rates.
- interest rates.
- office vacancies.
- real estate absorption rates.
- trade deficit.
- wages and salaries.
- unemployment rates.
- country risks.[73]

Several sources are available within the OCC to help examiners obtain economic information. Examiners can access many economic resources from the OCC's Economics Department. The Bank Supervision Policy Department produces valuable analysis on national and local financial and economic trends. The OCC's National Risk Committee produces the *Semiannual Risk Perspective* report, which provides economic and trend analysis. Examiners may request specific information by contacting an OCC subject matter expert or through the OCC Library. In some cases, examiners may need more specific economic information. For example, if concerns about an industry arise (e.g., agriculture),

[72] The FDIC Failed Bank List provides information on all failed banks since October 1, 2000.

[73] Refer to the "Country Risk Management" booklet of the *Comptroller's Handbook.*

examiners may consider reviewing industry studies, trade data (e.g., U.S. Department of Agriculture crop price reports), local publications, and National Risk Committee or subcommittee information.

Examiners may use these resources and other supervisory information to assess a bank's potential exposure to deteriorating economic conditions. Examiners should use the information to assess red flags in in the bank's loan portfolio, credit loss allowance, capital adequacy, IRR, and liquidity risk.

Problem Bank Rehabilitation

The OCC has a long history of effective rehabilitation of problem banks. The OCC's goal is to rehabilitate and return a problem bank to a safe and sound condition. Rehabilitation focuses on the root cause of the bank's condition and the actions needed to restore the bank to a safe and sound condition. Rehabilitation is based on developing a specific and viable rehabilitation plan for each problem bank and subsequent monitoring to assess progress. This section focuses on the range of supervisory and enforcement approaches the OCC uses. Supervisory and enforcement responses typically increase in severity as a bank's condition deteriorates, and typically decrease in severity as a bank's condition improves.[74] If rehabilitation is not successful, resolution may be necessary.[75]

Supervisory Actions

The OCC uses various supervisory actions to address banks' deficiencies. Examiners should be familiar with the full range of OCC supervisory actions: MRAs, citations of violations of laws or regulations, informal enforcement actions, formal enforcement actions (including CMPs), and PCA measures.

The OCC typically first cites a violation or issues a concern in an MRA to address a bank's deficiencies. Violations, concerns in MRAs, or unsafe or unsound practices may serve as the basis for an enforcement action. The OCC uses enforcement actions to require a bank's board and management to take timely actions to correct a bank's deficiencies. The OCC takes enforcement actions against banks and their current or former IAPs. The OCC should take more severe action if the board and management failed to correct previously identified deficiencies. If the board and management have a proven track record of implementing timely and effective corrective action, a less severe action may be warranted, unless the deficiencies are significant, or the bank's condition is deteriorating rapidly. Regardless of the type of action used, examiners should tailor corrective actions to the bank's specific circumstances. Tailoring corrective actions helps bank management to correct the deficiencies and return the bank to a safe and sound condition as soon as possible.

When examiners identify deficient practices, they must not defer communicating the OCC's concern (i.e., issuing MRAs) pending bank management's efforts to address the deficient practices. Examiners must not use a graduated process by first communicating the OCC's concern with a deficient practice as a recommendation, then, if the deficient practice is not addressed, in an MRA. Use of recommendations should be infrequent in problem bank supervision because management and the board should focus on correcting deficiencies and

[74] Even when a bank's condition is improving, it is consistent with the OCC's enforcement action policy to require a bank to comply with existing enforcement actions. There may be cases in which an enforcement action is terminated or replaced before a bank is in compliance with the action (e.g., the enforcement action becomes outdated or irrelevant to the bank's circumstances).

[75] For more information, refer to the "Resolution" section of this booklet.

improving the financial condition of a problem bank rather than making optional enhancements.

This booklet focuses primarily on enforcement actions rather than MRAs and citations of violations. For more information about MRAs and violations of laws and regulations, examiners should refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

Policies and Procedures Manual (PPM) 5310-3, "Bank Enforcement Action and Related Matters,"[76] provides guidance in selecting the actions best suited to resolve a bank's deficiencies and promotes consistency while preserving flexibility for individual circumstances. PPM 5310-3 describes when and how to use informal and formal enforcement actions and describes the types of informal and formal enforcement actions.

The following questions can be useful when assessing the bank's specific circumstances and determining the appropriate supervisory action:

- **What types of problems has the bank had in the past?** If deficiencies are similar to past ones, the bank may not have corrected the root cause and additional corrective actions may be warranted.
- **Has the severity of problems progressed?** If the deficiencies' severity is increasing or the bank's condition is deteriorating, more vigorous corrective action is typically warranted.
- **Has the bank's ownership, board, or management composition changed?** If not, examiners should consider the type of response to previously identified deficiencies. If a change in board and management has occurred, examiners should look at responsiveness to recent deficiencies, if applicable.
- **Does the bank proactively self-identify and correct deficiencies?** The board and management's ability and willingness to self-identify deficiencies is important in determining the nature and form of supervisory response. Examiners should consider the extent to which management corrects deficiencies identified by independent risk management reviews (e.g., credit risk review, compliance reviews) or auditors in a timely manner. If examiners routinely identify problems with the bank self-identifying and correcting deficiencies, the board and management may need more corrective action guidance or more severe supervisory action.
- **Does the board or management have the expertise to fix the deficiencies?** If not, the board and management may need more corrective action guidance or more severe supervisory action.
- **Has the bank been under an enforcement action before? If so, how long ago and for what?** The date and nature of a prior action may indicate the need for a new enforcement action to require the bank to correct deficiencies.

[76] PPM 5310-3 was conveyed by OCC Bulletin 2018-41, "OCC Enforcement Action Policies and Procedures Manuals."

Informal Enforcement Actions

PPM 5310-3 states that deficiencies in a bank with a composite CAMELS or ROCA rating of 1 or 2 can typically be addressed using MRAs or citations of violations in a formal written communication. An enforcement action may be warranted based on the severity of deficiencies or the board and management's failure to address previously identified deficiencies. Enforcement actions generally increase in scope and severity when the OCC has low confidence in the board or management's willingness or ability to correct deficiencies. The decision to recommend stronger enforcement action is the supervisory office's responsibility and should be based on the bank's ratings, the deficiencies' severity, the level of risk, and the board and management's ability and willingness to correct the deficiencies within an appropriate period.

Informal enforcement actions also put the board and management on notice in case a formal action may be necessary later. Informal enforcement actions commonly provide more guidance and detail about corrective actions and the board's commitments to correct deficiencies than MRAs. Informal enforcement actions are generally not enforceable in court, and the OCC generally cannot assess CMPs for noncompliance with an informal action. Therefore, if an informal action does not result in the desired outcome, examiners should consider escalating to a formal enforcement action to hold management and the board accountable. Informal enforcement actions are typically not published or made available to the public.

Formal Enforcement Actions

For 3-rated banks, there is a presumption for use of a formal enforcement action. PPM 5310-3 states that the presumption for using a formal enforcement action is particularly strong when

- the bank is deteriorating because of declining trends in financial performance or an increasing risk profile.
- the bank has a less-than-satisfactory management component rating (3 or worse).
- there is uncertainty as to whether the board and management have the ability and willingness to correct identified deficiencies within an appropriate time frame.

A presumption also exists to take formal action against 4- and 5-rated banks. Specifically, while the board and management's ability and willingness to correct deficiencies within an appropriate time frame are factors in deciding the type of an enforcement action, the OCC has a presumption in favor of using a cease-and-desist order, a consent order, or a PCA directive, given the condition and high risk profile of composite 4- and 5-rated banks. Assessing the capability, cooperation, integrity, and commitment of the bank management and its board is important but should be weighed with the presumption in favor of a formal action when the bank's ratings or financial condition warrant strong action.

Formal enforcement actions are appropriate when a bank has significant problems, especially when there is a threat of harm to the bank or the bank has previously failed to correct

deficiencies. There is a presumption for formal action, regardless of the bank's capital level and composite rating, when one or more of the following conditions exist:

- The bank exhibits significant deficiencies in its risk management systems, including policies, processes, and control systems.
- There is significant insider abuse.
- There are systemic or significant violations of laws or regulations.
- The board and management have disregarded, refused, or otherwise failed to correct previously identified deficiencies, including
  - noncompliance with an existing enforcement action.
  - failure to correct concerns communicated in MRAs.
  - failure to correct violations of laws or regulations.
- The board and management have refused or failed to satisfactorily maintain the bank's books and records; have attempted to place unreasonable limitations on how, when, or where an examination is conducted; or have imposed limits or restrictions on examiner access to the bank's personnel, books, or records.

Formal enforcement actions are made enforceable by statute. The OCC can assess CMPs against banks and individuals for noncompliance with a formal agreement, consent order, or cease-and-desist order and can request a federal court to issue an injunction requiring the bank to comply with some formal actions. Unlike informal actions, formal enforcement actions are typically made available to the public or published on the OCC's web site.

The supervisory office should consider CMP assessments[77] or more severe actions in cases of substantial noncompliance with a formal enforcement action. Ultimately, if the OCC's enforcement tools do not result in management and the board successfully rehabilitating a bank, the OCC determines whether receivership or conservatorship is appropriate. For more information, refer to the "Grounds for Receivership" section of this booklet.

Prompt Corrective Action Measures

PCA[78] establishes a framework of restrictions and requirements for banks based on capital categories. PCA regulations define the capital measures and capital levels that are used to apply the restrictions provided for under PCA. The regulations establish procedures for submission and review of capital restoration plans (CRP), establish procedures for issuance and review of directives and orders pursuant to PCA, and identify specific restrictions based on a bank's PCA category.

PCA requires that the banking agencies take increasingly severe supervisory and enforcement actions as a bank's capital level diminishes. For banks that are undercapitalized, significantly undercapitalized, or critically undercapitalized under the PCA regulations, PPM 5310-3 states the supervisory office should consider using a PCA directive. Whatever

[77] For more information about CMPs, refer to PPM 5000-7, "Civil Money Penalties." PPM 5000-7 was conveyed by OCC Bulletin 2018-41.

[78] The PCA statute is 12 USC 1831o and its implementing regulation is 12 CFR 6.

option the OCC chooses, additional mandatory PCA restrictions apply automatically to banks that are undercapitalized, significantly undercapitalized, and critically undercapitalized.

For a detailed discussion of PCA and related actions, refer to the "Prompt Corrective Action" section of this booklet.

Enforcement Action Process

The timeliness of corrective action is critical. The OCC's policy is to take bank enforcement actions as soon as practical, including during an examination if circumstances warrant. The supervisory office should recommend initiating an enforcement action, or modifying or replacing an existing action, as soon as possible upon completion of examination work. When possible, the proposed enforcement action should be presented to the bank within 180 days of the start of a supervisory activity that results in any formal written communication that[79]

- states that the bank is experiencing one or more significant deficiencies listed in section III of PPM 5310-3.
- assigns a composite CAMELS or ROCA rating of 3, 4, or 5.
- states that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized.
- states that an undercapitalized bank failed to submit an acceptable CRP or failed in some material respect to implement it.
- states that the bank is in noncompliance with the safety and soundness guidelines (12 CFR 30, appendix A).

The supervisory office documents the recommendation to proceed with an enforcement action and records the recommendation and final decision in the OCC's supervisory information system. For many enforcement actions, the supervisory office provides the board, or its duly authorized representative, a copy of the proposed enforcement action. Then the supervisory office meets with the board to present the document and obtain signatures for the enforcement action's execution as soon as practical.[80]

Content of Enforcement Actions

Bank enforcement actions must address deficiencies documented in a related formal written communication or otherwise uncovered during an examination or investigation, as appropriate. Enforcement actions should address the most substantive deficiencies. Although most enforcement actions are written using standard language, the supervisory office should tailor corrective actions to the bank's specific deficiencies. Although not mandatory, consent orders addressing a problem bank's safety and soundness issues typically have an article requiring a minimum capital level, as capital is a critical factor in many supervisory decisions

[79] For more information about timeliness of enforcement actions, refer to section VII of PPM 5310-3.

[80] For more information, refer to the "Finalizing Enforcement Actions" section of this booklet and appendix C of PPM 5310-3.

affecting the bank. The supervisory office may choose to proceed with individual minimum capital ratios (IMCR), which is an informal enforcement action, rather than including a capital article requiring capital minimums in a formal enforcement action.

The final enforcement action must

- identify the underlying basis for the enforcement action.
- specifically state any requirements placed on the bank and list any limitations on the bank's activities.
- be explicit to guide the board's or management's corrective actions and facilitate OCC follow-up activities.
- assign time frames by which the board or management must act, complete any corrective actions, or be subject to restrictions or limitations on activities.

Finalizing Enforcement Actions

Appendix C of PPM 5310-3 describes bank enforcement action processes and time frames. The process often includes providing a copy of the proposed enforcement action to the bank within 30 days of the OCC's final decision to take the action.[81] Examiners guide the board through executing an enforcement action and request the directors' consent to the action. The OCC may consider bank responses to the proposed enforcement action before finalizing the enforcement action.

After providing the proposed enforcement action to the applicable bank representatives and resolving outstanding issues, the OCC typically schedules a board meeting to formally present the enforcement action to the bank and request directors' signatures. The board meeting is not a forum for negotiating the content of the enforcement action. During this meeting, the EIC should stress that the board and the OCC have the same goals for the bank (e.g., a safe and sound bank). The enforcement action is a blueprint for the board to meet those goals.

An OCC attorney often attends the board meeting when the OCC presents a proposed enforcement action for signature. The OCC attorney answers legal questions and explains the enforcement action process. The OCC may not know in advance of the board meeting whether the board is willing to sign. The enforcement action becomes effective when the majority of the bank's directors and the OCC execute the action. If the board does not sign the enforcement action, the OCC may serve a notice of charges. The notice of charges is a public document that alleges unsafe or unsound practices and violations of laws and regulations identified through the examination process that correspond to the articles in the proposed enforcement action. Serving the notice of charges starts the administrative hearing process. Even after the notice of charges is served, the directors may execute the proposed enforcement action, which will result in the dismissal of the notice of charges.

[81] Some enforcement actions are imposed by the OCC and effective immediately. This section of the booklet focuses primarily on presenting proposed enforcement actions to the board for consent, which is more common than imposing an action immediately.

Enforcement Action Follow-Up Activities

Once an enforcement action is executed, the bank must successfully implement the corrective actions. Examiners can facilitate the change with clear, timely, and direct communication on corrective actions and should provide a clear record of where the bank is falling short of the enforcement action requirements.

Examiners should communicate with the bank in writing on a regular basis regarding the status of a bank's compliance with the enforcement action. PPM 5310-3 requires examiners to perform the first assessment of a bank's compliance with an enforcement action within 180 days of the date the enforcement action was executed. For a problem bank, the timing of subsequent follow-up activities may not align with the examination schedule. Instead it should align with corrective action due dates and the bank's action plans. During follow-up activities, examiners should provide clear, timely feedback and guidance.

Upon completing follow-up activities, examiners must determine whether the bank has met the requirements of each article and designate the article as in compliance or not in compliance. When an article is in compliance, the bank has adopted, implemented, and adhered to all of the corrective actions set forth in the article; the corrective actions are effective in addressing the deficiencies; and OCC examiners have verified and validated the corrective actions. A bank is not in compliance with an enforcement action article merely because it has made progress or a good faith effort.[82] The OCC may take more severe action if the bank does not comply with the enforcement action. The OCC may also assess CMPs against the bank or its IAPs for noncompliance with certain types of enforcement actions. The supervisory office may, in its discretion, grant reasonable extensions to comply with articles that require developing and implementing policies, procedures, systems, and controls.

Examiners must provide written communication to the bank after completing verification or validation activities or in response to a bank's submission or request. Examiners must also provide written communication after periodic monitoring (e.g., quarterly monitoring) if substantive concerns arise. OCC communications to the board must detail what the bank must do to achieve compliance with articles that are not in compliance.[83]

Examiners should incorporate results of each examination or monitoring activity into the supervisory strategy for the bank. For example, based on the severity of the bank's deficiencies and the compliance status of each article, additional follow-up activities may be necessary. During supervisory activities, examiners should assess whether

- the enforcement action is having its intended effect.
- the content of the enforcement action is appropriate for the bank's situation.

[82] For more information about assessing compliance with enforcement actions, refer to section IX of PPM 5310-3.

[83] For more information about communicating enforcement action compliance, refer to section X of PPM 5310-3.

If not, examiners should recommend amending, terminating, or replacing the enforcement action. An enforcement action should not be terminated unless[84]

- the bank is in compliance with all articles of the enforcement action,
- the OCC determines that articles deemed "not in compliance" have become outdated or irrelevant to the bank's current circumstances, or
- the OCC incorporates the articles deemed "not in compliance" into a new action.

Meetings

Effective, accurate, and frequent communication with management, the board, and other regulators is critical in problem bank supervision to ensure bank management and the board resolve deficiencies. Examiner communication must reflect the situation's severity. Communicating too harshly or not firmly enough can threaten the timely resolution of deficiencies. As examiners identify deficiencies that could adversely affect the bank, they should discuss them with management and the board as soon as practical. Doing so can help ensure identification and knowledge of the deficiency, encourage timely corrective action, and prevent surprises when disclosing ratings in written communication. Examiners should be prepared for a range of reactions. During these meetings, examiners must allow management and the board to clarify misunderstandings and commit to corrective action.

The EIC should discuss preliminary findings, including ratings, deficiencies, and corrective actions, with the appropriate supervisory office throughout the examination. Discussions help ensure that the OCC applies policy consistently and that OCC management supports the conclusions and corrective action. Discussions also help prepare the EIC to present the findings to bank management and the board. Coordination with the supervisory office helps ensure consistency in tone and content between examiner comments in meetings and written communication with the bank. Any intention to recommend an enforcement action should be communicated verbally so that management and the board are not surprised by subsequent written communications.

Exit Meetings

At the conclusion of an examination, examiners should hold an exit meeting with management and, as appropriate, directors, to summarize conclusions, deficiencies, corrective actions, and planned OCC follow-up, including the potential for an enforcement action, as applicable. This is an opportunity for examiners to reaffirm and prioritize conclusions discussed earlier in the examination. In some cases, a representative of the supervisory office may attend the exit meeting. Before mentioning an enforcement action to management and the board, the EIC should discuss with the supervisory office and OCC legal counsel. Examiners should generally not disclose ratings to a problem bank until the supervisory office finalizes the report of examination (ROE) or supervisory letter. During the exit meeting, examiners should

[84] For more information about terminating enforcement actions, refer to section XI of PPM 5310-3.

- share key facts and findings that will be used to support ratings and risk assessment system conclusions.
- prioritize the concerns by risk and severity.
- clearly describe expectations for corrective action.
- discuss specific management weaknesses independent of overall conclusions on management oversight.
- obtain commitments for corrective action. Commitments should identify responsible individuals and time frames.

Board Meetings

Examiners must meet with a bank's board at least once during each supervisory cycle, per OCC policy. It may be necessary to hold meetings with a problem bank's board more often than once during each supervisory cycle. Examiners should meet with the board of a problem bank whenever there is material information to convey. Common topics discussed with directors include examination conclusions, supervisory plans, corrective action updates, and enforcement actions.[85]

Ideally, the board will be compelled by its fiduciary duty and responsibility to restore the bank to a safe and sound condition, and in those cases, the meetings can be productive. Occasionally, the meetings are contentious, which further supports the requirement to maintain an adequate written record of examination findings.

In addition to meeting with the entire board, it is beneficial to consider meeting with the independent directors without management or bank insiders present. These executive sessions can be particularly helpful when a bank is 4- or 5-rated, there are insider issues, or management or the board are not fully engaged in rehabilitating the bank; however, executive sessions are useful in any problem bank. These meetings provide independent directors a forum to express their candid views and ask questions and can increase communication and commitment from the independent directors.

Written Communication

Written communication is essential to effective bank supervision. Written communication should focus management and the board's attention on the OCC's major conclusions, including any supervisory concerns. In addition, written communication, along with other related correspondence, helps establish and support the OCC's supervisory strategy.

Written communication for problem banks is particularly important because it comprises the documentation needed to take enforcement or supervisory action, including receivership, when warranted. Written communication includes ROEs, supervisory letters, and other correspondence.

[85] For more information regarding board meetings, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook.*

The OCC sends written communication when it is

- issuing an MRA or citing violations of laws or regulations.[86]
- changing any composite or component rating.
- changing an aggregate risk assessment system (RAS) assessment.
- providing the bank with a status update regarding a previously communicated MRA or violation of law or regulation.
- providing the bank with a status update regarding an enforcement action.
- responding to correspondence from the bank.

The OCC must provide an ROE to the board at least once during each supervisory cycle. The results of supervisory activities conducted during the supervisory cycle should be communicated as they occur. For a problem bank, sending an ROE more than once per cycle could be warranted. Because the OCC generally conducts examinations of problem banks at least every six months, examiners should consider issuing an ROE after each full scope and interim examination. For a 4- or 5-rated problem bank, it is generally preferable to issue an ROE for interim examinations, particularly if the bank is deteriorating or not making sufficient progress remediating concerns. The supervisory office has discretion whether to issue an ROE or a supervisory letter for any supervisory activity. The supervisory office should consider whether an ROE or supervisory letter would most effectively convey the information, particularly for target or interim examinations. Some considerations when determining whether to use an ROE instead of a supervisory letter include

- the nature and extent of the bank's deficiencies.
- whether the bank's condition is deteriorating.
- whether the bank is making sufficient progress in addressing the deficiencies and rehabilitating the bank.
- the nature and extent of any changes to ratings or RAS conclusions.
- whether the format of an ROE or supervisory letter would be most useful to the reader.

A supervisory letter typically provides conclusions from a target or interim examination, communicates the status of MRAs or violations, or responds to bank correspondence. Supervisory letters in these contexts are separate and distinct from those used in the IAP enforcement context.[87] For problem banks, the supervisory office may also issue a supervisory letter that directs bank management to cease unsafe or unsound practices and take necessary sustainable corrective action. Supervisory letters can be an effective tool to require corrective action within a specified time before further deterioration of the bank's overall condition. Supervisory letters can be used to address deficient risk management

[86] Some violations may be communicated to management in a list outside of a formal written communication. For more information, refer to the "Violations of Laws and Regulations" section of the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

[87] For more information related to issuance and use of a supervisory letter as an IAP informal enforcement action, refer to PPM 5000-7, "Civil Money Penalties"; PPM 5310-3, "Bank Enforcement Actions and Related Matters"; and PPM 5310-13, "Institution-Affiliated Party Enforcement Actions and Related Matters."

practices and excessive risks identified by examiners during supervisory activities before issuing an ROE.

Developing written communication for problem banks involves collaboration with the supervisory office, OCC legal counsel, and subject matter experts because it often deals with complex issues and significant weaknesses. Precise wording is important to clearly and concisely supporting conclusions, eliciting corrective actions, and documenting the OCC's supervisory record. For clarity and effectiveness, written communication for a problem bank should

- convey the information necessary for bank management and directors to understand the bank's condition, including the relative severity of deficiencies, who is responsible, and the effect on the bank if left uncorrected. Providing the specific name and title of the individual responsible for the deficiency is important since the written communication is used to support any potential action taken against an individual.
- emphasize the most critical deficiencies, including past-due concerns or violations and noncompliance with articles of an enforcement action, and identify the root cause.
- remain balanced and objective.
- be consistent with verbal communications, including exit meetings and board meetings.
- reflect the stage of the bank's rehabilitation and management's willingness and ability to correct deficiencies.
- describe corrective actions in enough detail so that no ambiguity exists about responsibility (who, what, and when) for corrective actions.
- contain sufficient information to support appropriate enforcement action or potential resolution.

For more information regarding written communication, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

Appeals

The existence of a formal bank appeals process does not change the core policy of the OCC concerning dispute resolution, which is to resolve disputes in an informal, amicable manner. When a bank cannot resolve disagreements through discussions with examiners or the supervisory office, examiners should inform the bank of its options under the OCC's appeals process. To enhance transparency and communication throughout the process, early contact with the Ombudsman's office by banks and OCC supervisory personnel is actively encouraged. The OCC's appeal process is described in OCC Bulletin 2013-15, "Bank Appeals Process: Guidance for Bankers."

There are several relevant actions that a problem bank may not appeal to the OCC's Ombudsman or the supervisory office, such as[88]

- appointments of receivers and conservators.

[88] Refer to OCC Bulletin 2013-15 for a full list of items that may not be appealed.

- preliminary examination conclusions before the OCC issues a final ROE or other written communication.
- formal enforcement-related actions or decisions (e.g., a decision to seek a formal enforcement action); however, banks may appeal conclusions in the ROE resulting in the enforcement action.
- decisions to disapprove proposed changes in directors or senior executive officers pursuant 12 CFR 5.51.

Examples of decisions or actions that a bank may appeal include

- examination ratings.
- individual loan ratings.
- violations of laws and regulations.
- material supervisory determinations such as MRAs, compliance with enforcement actions, or other conclusions in an ROE or supervisory letter.

A bank may seek a review of appealable matters by filing an informal appeal with its local supervisory office, or by filing a formal appeal with its applicable Deputy Comptroller or the Ombudsman. If a bank files an informal appeal with its local supervisory office and is dissatisfied with the appeal decision, it may further appeal the matter to its Deputy Comptroller or directly with the Ombudsman. In the absence of any extenuating circumstances, the OCC issues a written response to an informal appeal within 10 days of receipt and a response to a formal appeal within 45 days of receipt.

Communication With Other Regulators

Ongoing communication with other regulators is necessary for collaboration on problem bank issues. The supervisory office should routinely communicate with the FDIC on the status of problem banks because the FDIC has backup regulatory authority due to its role to protect the DIF. The FDIC often participates in problem bank examinations.[89] Supervision of problem banks with holding companies also involves ongoing communication with the appropriate Federal Reserve Bank or Board of Governors of the Federal Reserve System. Communicating concerns to other regulators should take place well before the OCC begins coordinating a bank resolution or conservatorship. Communication typically becomes more frequent as bank conditions worsen. Communication should be consistent with information-sharing agreements, OCC policy, and delegations of authority.

Matters Affecting Directors and Management

The following are some common matters related to problem banks that can affect bank directors or management:

[89] An Interagency Memorandum of Understanding on Special Examinations, dated July 14, 2010, allows the FDIC to coordinate with a depository institution's primary regulator to conduct a special examination to determine the institution's condition for insurance purposes.

- A bank that is in troubled condition
  - must submit prior notice to the OCC of proposed changes in directors and senior executive officers.[90]
  - is prohibited from making, or agreeing to make, golden parachute payments to IAPs without OCC and FDIC approval, pursuant to 12 CFR 359.[91]
- The OCC can take enforcement actions, including CMPs, against current or former IAPs.[92]
- An individual who has been convicted of, or entered into certain judicial programs as an alternative to prosecution for, certain crimes is automatically prohibited by operation of law from being an IAP, owning or controlling any insured depository institution, or otherwise participating in the affairs of any insured depository institution except with the prior written consent of the FDIC.[93]
- FDIC-insured banks are subject to certain restrictions and actions depending on the bank's PCA capital category. These can include a PCA dismissal, which is the dismissal of a director or senior executive officer from office. A PCA dismissal is a PCA action against a bank, but the director or senior executive officer subject to the dismissal has certain procedural rights.[94]

Changes in Directors or Senior Executive Officers

Pursuant to 12 USC 1831i, as implemented by 12 CFR 5.51, certain banks must give prior notice of proposed changes in directors and senior executive officers. The OCC must complete its review of that notice within a certain time frame. 12 CFR 5.51 applies to both FDIC-insured and uninsured national banks, all FSAs, and all federal branches.[95] The OCC may require prior notice of changes in directors, senior executive officers, or other employees separate from its authority under 12 CFR 5.51. This section of the booklet highlights key points for examiners regarding the prior notice requirements under 12 CFR 5.51. Examiners should refer to the "Changes in Directors and Senior Executive Officers" booklet of the *Comptroller's Licensing Manual* for a full discussion of the OCC's policies and procedures for changes in directors and senior executive officers under 12 CFR 5.51.

A bank is required to file an "Interagency Notice of Change in Director or Senior Executive Officer" at least 90 days before a proposed director or senior executive officer's directorship, employment, or change in responsibilities, when one of the following circumstances exists:

[90] Refer to the "Changes in Directors and Senior Executive Officers" section of this booklet.

[91] Refer to the "Golden Parachute Payments" section of this booklet.

[92] Refer to PPM 5310-13 and PPM 5000-7.

[93] Refer to 12 USC 1829, "Penalty for Unauthorized Participation by Convicted Individual."

[94] Refer to the "Prompt Corrective Action" section of this booklet.

[95] Refer to 12 CFR 5.51(c)(3), which provides that the term "national bank" includes a federal branch for purposes of 12 CFR 5.51.

- The bank is in troubled condition.
- The bank is not in compliance with minimum capital requirements as prescribed in 12 CFR 3.
- The OCC determines, in writing, in connection with the review by the agency of a plan required under section 38 of the Federal Deposit Insurance Act,[96] or otherwise, that such prior notice is appropriate.

The OCC may waive prior notice at its discretion, provided certain criteria are met, but may not waive the required filing of the notice.[97] The OCC may permit a streamlined notice in certain cases.

The OCC performs background checks on proposed directors or senior executive officers for a bank subject to the prior notice requirements under 12 CFR 5.51.[98] Banks are responsible for conducting their own due diligence and background investigations on proposed directors or senior executive officers.

The OCC has up to 90 days from receipt of a technically complete notice to complete its review. The OCC may either disapprove or indicate its intent not to disapprove a notice. The OCC's decision is based on the information collected during the background investigation, including an interview of the individual, if warranted. The OCC may disapprove an individual if the OCC determines on the basis of the individual's competence, experience, character, or integrity that it would not be in the best interests of the depositors of the bank or the public to permit the individual to be employed by or associated with the bank. In some cases, the OCC may impose enforceable conditions with its intention not to disapprove an individual. Examples of grounds for disapproval of a notice include

- mismanagement of a financial institution when the proposed individual had control, was a director or senior executive officer, or was in a decision-making capacity.
- improper benefit from insider transactions at previous financial institutions.
- conviction of a crime.[99]
- discipline, censure, or denial of the right to do business or practice a profession by a state or federal regulatory agency or license-granting body.
- submission of an inaccurate or misleading notice.

[96] Section 38 of the Federal Deposit Insurance Act is the prompt corrective action statute codified at 12 USC 1831o.

[97] Refer to 12 CFR 5.51(e)(6)(i), "Waiver Request."

[98] For more information, refer to the "Background Investigations" booklet of the *Comptroller's Licensing Manual*.

[99] An individual who has been convicted of any criminal offense involving dishonesty, breach of trust, or money laundering, or who has entered into a pretrial diversion or similar program in connection with prosecution of such offense(s), must obtain approval from the FDIC before he or she may own, control, participate in the affairs of, or become an institution-affiliated party of a depository institution. Refer to 12 USC 1829.

- insufficient experience in a comparable position to perform adequately the duties and responsibilities of the proposed position.

Golden Parachute Payments

This section of the booklet applies only to FDIC-insured banks.

A golden parachute payment is any payment of compensation (or agreement to make such a payment) to a current or former IAP of an FDIC-insured bank that meets three criteria.[100] The payment or agreement must be

- contingent on, or by its terms is payable on or after, the termination of the IAP's primary employment or affiliation with the bank.
- received on or after, or made in contemplation of, one of several events, including a determination that the bank is in troubled condition.
- payable to an IAP whose employment or affiliation with the bank is terminated at a time when the bank meets one of several conditions, including being subject to a determination that it is in troubled condition.[101]

12 CFR 359 permits a bank to make golden parachute payments, or enter into agreements providing for golden parachute payments, when the bank obtains the prior consent of the OCC and, in most cases, the concurrence of the FDIC.[102]

A bank making a request under 12 CFR 359.4 must demonstrate and certify it does not possess and is not aware of information, evidence, documents or other materials that would indicate there is a reasonable basis to believe that the IAP engaged in certain misconduct or violations of law or is substantially responsible for the bank's troubled condition.[103] FDIC FIL-66-2010, "Guidance on Golden Parachute Applications," provides more information regarding the type of information required. FIL-66-2010 provides that certain banks may make a de minimis golden parachute payment of up to $5,000 per individual without regulatory review, as long as the bank maintains records detailing

- the recipient's name.
- date of payment.
- payment amount.

[100] Refer to 12 CFR 359.1(f), "Golden Parachute Payment."

[101] Even when an agreement to make a golden parachute predates the bank's troubled condition, any golden parachute payment payable under the agreement is prohibited by 12 CFR 359, without regulatory prior approval, while the bank is in troubled condition. Certain kinds of payments that would otherwise meet these requirements are not restricted because they are excluded from the definition of "golden parachute" under 12 CFR 359.1(f)(2), "Exceptions."

[102] For more information, refer to 12 CFR 359.4, "Permissible Golden Parachute Payments."

[103] For more information, refer to 12 CFR 359.4(a)(4), 12 CFR 303.244, and FDIC FIL-66-2010, "Guidance on Golden Parachute Applications."

- the bank's signed and dated certification regarding the factors under 12 CFR 359.4(a)(4)(i) through (iv).

Rehabilitation Considerations

It is important to focus on management and board oversight for effective rehabilitation. The most common cause of bank failure is the board or management's failure to identify, measure, monitor, and control risks. Failures of this kind can result in deficiencies that affect a bank's asset quality, earnings, capital, and liquidity. This section elaborates on specific focus areas for effective rehabilitation of asset quality, earnings, capital, and liquidity.

Asset Quality

Lending activities are a predominant source of many banks' income and risk. Off-balance-sheet activities, such as derivatives and securitizations, are sources of additional credit risk. Historically, before a financial crisis, underwriting standards steadily declined and inherent credit risk in the financial system increased. As underwriting standards loosened, the potential for loss in the event of default escalated. Underwriting weaknesses can have profound and far-reaching implications for the banking system in an economic downturn. Examiners should determine the level of existing and potential credit risk in a problem bank to develop realistic and appropriate supervisory strategies.

Loan Classification and Documentation

Increases in special mention and classified assets, and resulting increases in required credit loss allowance balances, are the most frequent cause of banks becoming undercapitalized or worse. Examiners should review and classify loans based on an assessment of the borrower's probability of default and the likelihood of orderly liquidation. Examiners should rate credits consistent with interagency classification standards.[104]

Examiners should adequately document loan downgrades and other asset write-downs to support required charge-offs and credit loss allowance provisions. Documentation is essential in determining accurate capital levels and whether there are legal grounds for closing the bank. For 4- and 5-rated banks, the portfolio manager, subject matter experts, and the PBS thoroughly review examiner loan conclusions to validate the examination findings and confirm that asset classifications and the methodology used to determine the required credit loss allowance balance are consistent with OCC policies and procedures.

Examiner loan write-ups are required for loans in a problem bank when management disagrees with the classification, a violation of law is involved, or an adversely rated loan is

[104] For the interagency classification standards, refer to the "Rating Credit Risk" booklet of the *Comptroller's Handbook*.

to an insider. Loan write-ups are also required in problem banks for loans in which the amount adversely rated exceeds the greater of $100,000 or 2 percent of the bank's capital.[105]

Examiner loan write-ups should be concise, clear, and support the rating decision, and are important for documenting the supervisory record for a problem bank. Loan write-ups should include comments pertinent to the loans and contingent liabilities subject to an adverse rating. A write-up should focus on matters relevant to the loan's adverse rating and collectability. The write-up should emphasize deviations from sound banking practices, exceptions to bank policy, and credit administration weaknesses that are germane to the credit's adverse classification or violation of law or regulation, as applicable. When portions of a borrower's indebtedness are assigned different risk ratings, the comments should clearly set forth the reason for the split ratings and should include any portions rated pass. The write-up should provide sufficient support for the rating, including summarizing the credit, its weaknesses, and the reason for the rating. Examiners should consider the volume and degree of risk-rating disagreements between the bank and the OCC. High volumes or significant variances in rating disagreements may indicate weaknesses in the bank's credit risk identification process or systemic risk-rating deficiencies, including the possibility that management is deliberately avoiding recognizing problem loans.

Credit Loss Allowances

Examiners should determine whether banks have an adequate credit loss allowance. The credit loss allowance balance should be commensurate with the characteristics and loss history of the bank's loan portfolio as well as external factors that influence collectability. In a problem bank, it is important to assess the consistency in the credit loss allowance's trend relative to the bank's credit quality trends. It is also important to identify and assess any changes in the methodology between reporting periods, particularly relative to qualitative factor adjustments, to determine whether changes are appropriate and consistent with GAAP.[106] For more information and examples regarding the credit loss allowance, refer to the OCC's *Bank Accounting Advisory Series*.

Earnings

Earnings are essential to banks' long-term viability. Earnings should support a bank's operations and provide for adequate capital and credit loss allowance levels. The amount of earnings a bank needs varies depending on the bank's unique characteristics and should be commensurate with the bank's risks.[107]

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[105] For more information regarding loan write-ups, refer to the "Rating Credit Risk" booklet of the *Comptroller's Handbook*.

[106] For banks that have not implemented the CECL methodology, refer to the to the "Allowance for Loan and Lease Losses" booklet of the *Comptroller's Handbook* and OCC Bulletin 2006-47. For banks that have implemented CECL, refer to OCC Bulletin 2020-49.

[107] For earnings considerations regarding mutual FSAs, refer to OCC Bulletin 2014-35, "Mutual Federal Savings Associations: Characteristics and Supervisory Considerations."

Less-than-satisfactory or deficient earnings contribute to bank failures, particularly when a bank's earnings become negative and erode capital. Asset quality problems can directly result in earnings deterioration from reduced interest income and increases in credit loss allowance provision expense but also indirectly through such items as increased workout expenses (e.g., increase in workout or collections staff, legal fees) and OREO holding costs.

Excessive overhead or executive officer compensation are other common issues that can lead to less-than-satisfactory or deficient earnings. Excessive compensation is prohibited as an unsafe or unsound practice and is considered excessive when amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder.[108] Overhead includes the bank's operational costs. Examiners should discuss with bank management reasons for high or significantly increasing overhead, with a focus on high salaries or bonuses and high occupancy expenses.

Examiners should identify the root cause of less-than-satisfactory earnings and require a bank to take corrective action to improve income and reduce expenses, ideally before earnings become deficient or critically deficient. The OCC often requires banks with less-than-satisfactory earnings to develop and implement a strategic plan to improve earnings. Examiners should encourage bankers to focus on realistic prospects for earnings improvement. Strategic plans should address the root cause of the bank's less-than-satisfactory earnings and should balance appropriate changes to the bank's income and expenses. Examiners should confirm that a bank does not cut essential controls or personnel, which could result short-term savings at the expense of longer-term controls and risk management.

It is generally not appropriate for problem banks to enter into high-risk activities to improve earnings, as problem banks typically do not have sufficient capital or risk management systems commensurate with such risks. Examiners should focus on planned balance-sheet changes that might improve earnings in the short term but ultimately result in increasing risks to the bank.

Capital Adequacy

Adequate capital levels enable banks to meet the credit needs of their communities and promote the stability of individual banks and the federal banking system. The regulatory capital framework is designed to ensure that a bank's capital is of a sufficient quality and quantity to support the bank's operations and risk profile, and to protect the DIF. The OCC expects a bank to hold capital commensurate with the nature and extent of the risks to which the bank is exposed, and for the bank's management to identify, measure, monitor, and control the bank's risks.[109]

[108] For more information about excessive compensation, refer to 12 CFR 30, appendix A.III, "Prohibition on Compensation That Constitutes Unsafe and Unsound Practice."

[109] For an expanded discussion of the regulatory capital framework, capital planning, and the OCC's assessment of capital adequacy, refer to the "Capital and Dividends" booklet of the *Comptroller's Handbook*.

The two primary components of the regulatory capital framework are 12 CFR 3 and 12 CFR 6. Capital levels under PCA (12 CFR 6) are distinct from capital adequacy principles under 12 CFR 3. PCA assigns banks to certain capital categories and subjects them to the respective requirements, limitations, and restrictions of those categories. Regardless of a bank's capital level, no bank is considered well-capitalized under PCA if it is subject to a formal enforcement action (e.g., formal agreement, cease-and-desist order, capital directive) that requires the bank to meet and maintain a higher level of capital.[110]

Although 12 CFR 3 specifies minimum capital requirements consistent with a bank's risk profile, that minimum may not accurately reflect the level of capital necessary to support the risk in the bank's operations. The OCC has the authority to require more capital than the minimums in 12 CFR 3 in banks with higher risk (e.g., through IMCRs). A bank in the well-capitalized category of PCA nevertheless can have inadequate capital for the purposes of 12 CFR 3 because of the bank's risk profile.

The assessment of a bank's capital adequacy and the assignment of the capital component rating include an analysis of many different risks and factors, individually and in the aggregate, that affect a bank's capital. Examiners determine a bank's capital adequacy based on the totality of a bank's circumstances beyond meeting minimum regulatory capital ratios. The conclusion regarding a bank's capital adequacy may differ from an evaluation of compliance with minimum regulatory capital requirements.

Examiners should assess the effectiveness of the bank's capital planning. It is important for banks to take timely action when they determine that capital is deteriorating or no longer supports the bank's risk profile. This should occur well before the bank's capital ratios fall below well-capitalized, as defined in PCA. If a bank does not raise capital independently, the OCC may use enforcement actions to require the bank to develop and implement a plan to improve capital. The following sections discuss topics examiners should consider when a bank needs to improve capital.

Reducing Total or Risk-Weighted Assets

A bank can take steps to improve its capital ratios by decreasing total assets or the aggregate risk weight of its assets. Those actions may only temporarily improve capital ratios and, in the long term, could increase the risk to earnings and capital. Examiners should review actual or planned balance-sheet changes to determine whether the actions effectively address the bank's capital issues. Examiners should be wary of changes to the balance sheet that improve a bank's capital position in the short term that are not part of a longer-term plan that adequately considers the bank's future financial condition. The following are examples of ways banks have historically improved capital ratios through balance-sheet changes:

[110] The "Prompt Corrective Action" section of this booklet includes a detailed discussion of PCA.

Reduce on-balance-sheet assets: There are many ways for a bank to accomplish this goal, such as

- selling assets directly.
- natural attrition (e.g., curtailing loan growth or investment securities purchases as balance-sheet assets are repaid or mature).
- securitizing bank assets. This is an activity that warrants examiner attention. If not used properly or managed effectively, asset securitization could increase a bank's risks.
- replacing investment securities used to manage IRR with off-balance-sheet interest rate swaps. A bank may be able to improve its capital ratios by using swaps instead of investment securities to manage IRR; however, in many cases, management does not have sufficient experience with swap transactions.

Sell appreciated or low-risk assets: A gain on the sale of assets increases net income, and when combined with the decrease in assets, improves the bank's capital ratios. Risk to the bank could increase if the resulting balance sheet has proportionately more assets that are depreciated, less liquid, higher-risk, or lower-yielding.

Engage in a sale/leaseback arrangement for bank premises: The bank sells real estate with an agreement to lease the property from the purchaser. Under this scenario, the bank has reduced its assets and, therefore, its capital ratios have improved, but the bank has added a lease expense.[111]

Replace higher-risk-weighted assets with lower-risk-weighted assets: For example, a bank could sell loans or reduce loan volume, and invest in U.S. government securities. Such balance-sheet restructuring does not guarantee the bank's viability. Low-risk assets generally earn a low return, and the bank may face earnings pressure and capital inadequacy that could lead to failure.

Dividends

A bank that has less-than-satisfactory capital should prevent further capital depletion. Depleting a bank's capital base to an inadequate level by paying dividends or repaying certain capital issuances is an unsafe or unsound banking practice, even though the failure to make such payments could have adverse market ramifications by signaling problems at the bank or its holding company. When reviewing dividends and debt retirement, examiners should assess the impact on the bank's capital adequacy. The OCC has statutory and regulatory authority to restrict capital outflows in certain circumstances. The OCC may require the bank to obtain reimbursement for dividend payments that violate laws or regulations.

National bank dividends must comply with the statutory requirements of 12 USC 56 and 60 and regulatory requirements of 12 CFR 5, subpart E. FSA dividends must comply with the

[111] For more information, refer to the "Bank Premises and Equipment" booklet of the *Comptroller's Handbook*.

regulatory requirements of 12 CFR 5.55.[112] All banks must comply with the dividend restrictions of PCA. Banks cannot pay a dividend if such payment results in the bank becoming less than adequately capitalized under PCA. 12 CFR 5, subpart E (national banks) and 12 CFR 5.55 (FSAs) require prior OCC approval of dividends under certain circumstances. The OCC rarely authorizes a problem bank to pay a dividend. Banks must also comply with regulatory restrictions on distributions or discretionary payments outlined in 12 CFR 3.11. To avoid restrictions on capital distributions and discretionary bonus payments, banks must hold a capital conservation buffer (CCB) of greater than 2.5 percent of risk-weighted assets in the form of common equity tier 1 capital. Banks whose capital ratios fall below the minimum capital requirements plus CCB are subject to increasing limits on capital distributions and discretionary bonus payments.[113]

In addition to the statutory and regulatory restrictions, the OCC may prevent the outflow of capital from a bank using enforcement actions. For example, an enforcement action that requires a bank to raise additional capital, or to maintain a certain level of capital, typically requires the bank to obtain prior OCC approval before paying a dividend.

In some cases, a problem bank might make an inappropriate expense reimbursement or payment that constitutes a dividend, even though the bank does not label the payment as a dividend. Examiners should pay attention to transactions with affiliates or insiders to determine that the bank's payments serve a legitimate purpose and are not concealing an impermissible dividend.

Restrictions on Repayments and Repurchases

OCC regulations generally restrict the repayment or repurchase of instruments that qualify as capital. In general, redemptions or repurchases of regulatory capital instruments require prior OCC approval except for the redemption of tier 2 instruments at maturity.[114] A bank must generally receive prior OCC approval to exercise a call option on any instrument included in additional tier 1 capital or tier 2 capital.[115]

PCA further prohibits critically undercapitalized banks from making any payments of principal or interest on the bank's subordinated debt (without prior approval) beginning 60 days after becoming critically undercapitalized.[116]

[112] Covered savings associations must comply with 12 CFR 5.55.

[113] Refer to the "Capital and Dividends" booklet of the *Comptroller's Handbook* for a complete summary of dividend requirements.

[114] Refer to 12 CFR 3.20(b)(1)(iii), 12 CFR 3.20(c)(1)(vi), and 12 CFR 3.20(d)(1)(x).

[115] Refer to 12 CFR 3.20(c)(1)(v)(A) and 12 CFR 3.20(d)(1)(v)(A).

[116] Refer to 12 USC 1831o(h)(2).

Raising Capital

Although not always possible in seriously troubled cases, a direct way for a problem bank to improve its capital ratios is by raising capital.[117] Banks can raise capital privately through a holding company, directors, other shareholders, or publicly by accessing the capital markets. Any capital raised must meet the eligibility requirements for common equity tier 1, additional tier 1, or tier 2 capital to be included in regulatory capital.[118] A common form of new capital for banks results from proceeds from a securities issuance by the holding company. A company experiencing significant financial difficulties may have trouble obtaining capital at reasonable rates because investors are reluctant to invest in risky or poorly performing companies.

In some cases, banks, and not holding companies, are subject to securities registration requirements. For example, if a privately owned bank decides to go public and raise capital by selling stock that will be traded on a stock exchange, the bank must comply with securities offering disclosure rules and other rules applicable to publicly traded banks. Raising capital in the capital markets, particularly for a private bank that wishes to become public, requires significant management time and effort and can be costly. 12 CFR 16 requires a detailed registration statement and prospectus for selling securities to the public. Before a bank can raise capital by selling securities, the OCC must declare the prospectus effective. A significant marketing effort usually is necessary to attract investors and inform them about the bank and usually necessitates board and management participation. Issuing new securities dilutes the ownership interest of existing shareholders and could depress the bank's stock price. In fact, many investors interpret the offering of new shares as an indicator of financial problems.

Capital Plans Under 12 CFR 3

The OCC may use a capital directive to require banks that do not meet the regulatory capital minimums to submit capital plans as described in 12 CFR 3. The availability of remedies under PCA has made the use of capital directives much more infrequent. In some cases, the OCC may determine that, because of the nature of the bank's activities, risk exposure, or financial condition, risk-based capital ratios that exceed the minimums in 12 CFR 3 are necessary. Once such minimum ratios are established, such banks are required to submit capital plans if their capital falls below the required amount. A capital plan submitted under 12 CFR 3 must describe how the bank will meet the minimum capital ratios (e.g., increase capital via a public offering, slow loan growth, sell assets) and present the timetable for the planned actions. Examiners review the plan to determine whether the bank's plans are realistic and address identified problems.

[117] This is not the case for a mutual federal savings association without first converting to a mutual holding company or a stock form of ownership.

[118] Refer to 12 CFR 3.20 and to the "Capital and Dividends" booklet of the *Comptroller's Handbook* for a complete summary of the regulatory capital eligibility requirements.

The OCC may require a bank to develop a capital plan under 12 CFR 3 before the bank becomes undercapitalized. Unlike the requirements under PCA, which focus solely on the amount of capital, the minimum capital ratios of 12 CFR 3 are based on the bank's risk profile. The OCC encourages a capital plan prepared under 12 CFR 3 to be consistent with CRP requirements under PCA to avoid duplication if the bank becomes undercapitalized. A capital plan submitted under 12 CFR 3 is not, however, acceptable as a CRP under PCA, unless it addresses the requirements of 12 USC 1831o(e).

Liquidity

Liquidity is the bank's ability to readily meet its cash and collateral obligations at a reasonable cost.[119] Cost in this context can be associated with either an acceptable cost of funds or the ability to fund without the sale of desired assets or the disruption of significant lines of business. The critical component in evaluating a bank's liquidity risk is market confidence in the bank's financial condition. The volatility of certain sources of funding (such as brokered deposits, internet deposits, and borrowings) make the management of liquidity risk more challenging for problem banks, and these sources of funding are typically more sensitive to market perceptions.

To remain viable, a bank must have liquidity—the ability to obtain cash for operations at a reasonable cost when needed. Managing a bank's liquidity, particularly when its financial deterioration is known to the public, can mean the difference between stability and a crisis, including insolvency. Examiners should be prepared to deal with wide-ranging liquidity events caused by actual or perceived problems in any area of the bank. Discretionary and mandatory supervisory actions can be necessary to prevent a bank's insolvency.

Liquidity in a problem bank can deteriorate rapidly. It is important for problem banks to recognize liquidity stress events and to execute their contingency funding plan (CFP). Examiners who identify emerging liquidity concerns in a problem bank may consider requiring the bank to report its liquidity position to the OCC monthly, weekly, or daily. Depending on the nature of the bank's problems and the competence of management, examiners may be the first to recognize an erosion in liquidity. It is possible for management to have a false sense that it can control events, such as deposit runoff, only to realize that conditions are beyond control. Early identification of potential liquidity problems is critical to ensure that the bank has time to execute contingency strategies.

Examiners should monitor management's reaction to a liquidity crisis. Many options are available in response to a liquidity crisis. It is critical for management to manage assets, liabilities, and off-balance-sheet cash flows. How management and the board manage the release of information to the public is as important as managing the bank's financial positions and cash flows. The public's perception of a bank's condition, and thereby perception of the safety of customer deposits, can change quickly because of negative news (whether substantiated or rumored) about a bank's soundness. Customer reaction, which is difficult to predict, helps determine the need for on-hand liquidity and access to contingency sources.

[119] Refer to the "Liquidity" booklet of the *Comptroller's Handbook.*

Examiners should determine whether the bank has effective processes to monitor and react to the contraction of deposits and other funding. The level and frequency of monitoring depends on the severity of a bank's liquidity position; however, examiners may request quarterly, monthly, weekly, or daily liquidity reporting from a bank if its financial condition deteriorates or heightened monitoring is otherwise necessary.

Examiners should assess a bank's quantity of liquidity risk and quality of risk management as conditions change. They should communicate changes in the assessments to the supervisory office as changes occur. If management is not responding adequately to the bank's liquidity situation, the OCC should take appropriate supervisory action. It may be necessary to include requirements for liquidity risk management practices in an enforcement action to require the board to exercise necessary oversight. For a bank experiencing serious liquidity problems, examiners should provide regular reports on the bank's current position to the supervisory office. Those reports should include information on the adequacy of short-term asset positions and contingency sources relative to short-term liabilities and erosion trends.

Examiners should provide information to the supervisory office on the holding company's longer-term liquidity position and prospects. This should include cash flow projections depicting the estimated volume and timing of funds flows and the effect of offsetting liquidity enhancement programs, such as asset sales. Those reports provide early warning of discount window usage or insolvency in the absence of outside support. Examiners should perform periodic assessments of the volume and types of uninsured funding.

Reliance on rate- and credit-sensitive funding sources poses significant risks and challenges to banks when not managed appropriately. Effective liquidity concentration risk management is critical. Institutional fund providers and other market-based sources are typically more rate- and credit-sensitive than a bank's retail deposit customers. Institutional customers are typically less willing to provide funds to banks facing real or perceived financial difficulties. Additionally, reliance on market funding sources makes banks more susceptible to general or regional economic conditions. If not managed properly, the cost and risks associated with market-based funding can outweigh the benefits of accessing these sources. Increased interest expense associated with wholesale funding can have a profound effect on the bank's net interest margin, and consequently affect earnings and capital.

A strong positive correlation exists between real or perceived asset quality problems and liquidity problems. Market confidence in a bank's financial condition is a critical element in assessing liquidity risk, especially for those banks reliant on wholesale funding sources. Liquidity crises at individual banks often occur after marketplace awareness of existing or expected erosion in asset quality, earnings, and capital. Asset quality problems can result in diminished liquidity through reduced cash flows from principal and interest payments the bank does not receive as expected. Additionally, declines in regulatory capital trigger regulatory restrictions on certain funding sources and create a strong correlation between asset quality problems and liquidity problems.

Liquidity Regulations

Examiners should consider requirements of relevant liquidity regulations. In certain cases, problem banks are not eligible for certain funding sources. This section of the booklet summarizes some key liquidity-related regulations.

Brokered Deposit Restrictions and Interest Rate Restrictions (12 CFR 337.6 and 12 CFR 336.7)

Banks that are not well-capitalized may not accept, renew, or roll over any brokered deposit.[120] A bank that is adequately capitalized as defined in PCA may, however, apply for and must receive an FDIC waiver to accept, renew, or roll over any brokered deposit.[121] Moreover, the effective yield on the deposits (including as an agent institution that receives a reciprocal deposit under 12 CFR 337.6(e)(2)(i)(C)) cannot be significantly higher than the prevailing rates of interest on deposits offered in the bank's normal market area.[122] Examiners should determine whether bank management monitors rates regularly to prevent violations. 12 CFR 337.6 imposes certain pricing restrictions on deposits obtained through a deposit broker. The term deposit broker includes any insured depository institution that is not well-capitalized and that engages in the solicitation of deposits by offering rates of interest significantly higher than the prevailing rates of interest on deposits offered in the bank's normal market area.[123] Consequently, the pricing restrictions usually apply to all deposit accounts in a problem bank that is not well-capitalized, including the bank's local customers' deposit accounts.

Further, banks that are not well-capitalized may not solicit deposits that exceed the higher of the national rate plus 75 basis points or 120 percent of the current yield on similar U.S. Treasury obligations or federal funds rate plus 75 basis points in accordance with 12 CFR 337.7.[124]

Reciprocal Deposits Limited Exception (12 CFR 337.6(e))

A capped amount of reciprocal deposits is not considered to be brokered deposits for a bank that

- is well-capitalized and has an outstanding or good composite rating, or
- is adequately capitalized and has a waiver from the FDIC allowing it to take brokered deposits.

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[120] Refer to 12 CFR 337.6(b)(3).

[121] Refer to 12 USC 1831f, "Brokered Deposits," 12 CFR 303.243, "Brokered Deposit Waivers," and 12 CFR 337.6, "Brokered Deposits."

[122] Refer to 12 CFR 337.6(a)(5)(iv).

[123] Refer to 12 CFR 337.6(a)(5)(iv).

[124] Refer to 12 CFR 337.7(c)(2), "Institutions That Are Not Well Capitalized."

The capped amount is the lesser of $5 billion or 20 percent of liabilities. If a bank falls below well-capitalized or a good composite rating and does not have an FDIC waiver, then the cap becomes the average amount of reciprocal deposits for the prior four quarters. Other key points of the regulation include the following:

- An outstanding or good composite rating means a rating of 1 or 2.
- A bank can continue to treat as nonbrokered any time deposits it received before a downgrade to a composite 3 or adequately capitalized.
- A well-capitalized bank rated 3 or worse cannot get a waiver from the FDIC to keep treating reciprocal deposits as nonbrokered, but an adequately capitalized bank can, regardless of its rating.
- De novo banks cannot benefit from this relief until they get their first composite rating.
- For a bank that is not well-capitalized, the interest rate cap (12 USC 1831f(e)) applies to all deposits, even reciprocal deposits.
- FDIC will measure reciprocal deposit amounts as of the call report date.

Federal Reserve Discount Window (12 CFR 201.5)

Undercapitalized banks may not have discount window advances outstanding for more than 60 days in any 120-day period. Critically undercapitalized banks may have discount window advances only during the five-day period that begins on the day they become critically undercapitalized.

Interbank Liabilities (12 CFR 206)

Banks must implement and maintain written policies and procedures to prevent excessive exposure to any individual correspondent bank, based on the condition of the correspondent.[125] A bank must monitor the financial health of its correspondent banks, considering capital, credit, liquidity, and operational risks. The lending bank may rely on another party for this information if the lending bank's board has reviewed and approved the general assessment or selection criteria used by that party. Based on the analysis, banks must establish limits on their financial exposure to correspondents.[126] Under 12 CFR 206.4, a bank's intraday credit exposure limit is 25 percent of the borrowing bank's total capital, unless the lending bank can demonstrate that its correspondent is at least adequately capitalized as defined in 12 CFR 206.5(a).[127]

[125] Refer to 12 CFR 206.3(a). Refer also to 12 CFR 206.3(d), which requires the policies and procedures to be approved by the board at least annually.

[126] Refer to 12 CFR 206.3(b) and (c).

[127] For purposes of 12 CFR 206, the term "adequately capitalized" is similar but not identical to the definition of that term as used for the purposes of the PCA standards.

Liquidity Risk Management

Banks use several tools to manage liquidity—two common tools are a funds flow analysis and a CFP. Although these tools should be included in any effective liquidity risk management system during normal times, they are critically important during a crisis. The funds flow analysis depicts a bank's historical sources and uses of funding and provides a general sense of funding activity and trends. The CFP is a forward-looking document that projects sources and uses of funding under alternative scenarios. The alternative scenarios may consider adverse circumstances for both the bank as well as the capital markets. It is important for the funds flow analysis and CFP to be tailored to the specific bank.

Funds Flow Analysis

Examiners can monitor liquidity by analyzing a bank's flow of funds. The analysis should include all significant balance sheet items. While the analysis should reflect the condition of the consolidated organization, the format used should allow examiners to distinguish bank assets and liabilities from those belonging to other entities within the organization. Because funds flow analysis and other critical liquidity data are real-time methods of measuring liquidity, examiners should be able to obtain data daily on request with no more than a one-day lag time. Funds flow analysis varies based on the bank's size and complexity.

Contingency Funding Plan

A CFP helps ensure that a bank can manage fluctuations in liquidity prudently and efficiently. Often, as a problem bank deteriorates, its alternative funding plans erode, and the CFP becomes less effective. Therefore, timely implementation of the CFP may necessitate management actions before a liquidity crisis. Regardless, the CFP formalizes orderly actions and is a useful tool even if actual stress events do not match the scenarios. Options to preserve liquidity may include

- curtailing or discontinuing lending.
- selling loans or other assets.
- pledging additional collateral to increase borrowing capacity.
- increasing deposit pricing, to the extent permissible.
- issuing more equity (e.g., raising capital).
- shortening asset maturities and lengthening liability maturities (e.g., lending short, borrowing long).
- soliciting new deposits from shareholders and directors.
- preparing to handle customer inquiries and educating customers on deposit insurance.

A CFP should define specific responsibilities and triggers for acting.[128] Management and board accountability for their role in making decisions, executing the CFP, and timely

[128] For more information regarding CFPs, refer to OCC Bulletin 2010-13, "Liquidity: Final Interagency Policy Statement on Funding and Liquidity Risk Management," and the "Liquidity" booklet of the *Comptroller's Handbook.*

communication is essential. It is important for problem banks to manage external communications with customers, the news media, and other interested public parties, as misinformation could be detrimental to the public perception of the bank. Most customers understand that FDIC insurance protection secures their deposit accounts, but loss of confidence in the bank or anxiety over rumors and uncertainty could still prompt customers to draw down or close their deposit accounts. It is also important for problem banks to maintain open and frequent communication with their credit providers to help ensure that borrowing lines remain available, even if restricted.

Liquidity Crisis Management

If the liquidity risk becomes more pronounced, examiners should consider correspondingly severe supervisory responses.

Communications With Bank Management

In banks experiencing significant liquidity deficiencies (e.g., actual or potential liquidity shortfall, risk management weaknesses, internal control weaknesses), examiners should review bank management's assessment of the cause and severity of the identified liquidity deficiency. The bank may have already implemented or tried to implement its CFP but may face difficulties because of eroding asset valuations, increasing collateral requirements from counterparties, or difficulty attracting or retaining core deposit accounts. Examiners should consider whether the bank's liquidity concerns expose any deficiencies that warrant communicating a concern in an MRA or taking an enforcement action.

Communications With OCC Management and Other Regulators

To facilitate the OCC's internal communications and decision making, the supervisory office should alert the OCC's Press Relations unit of potential or real liquidity problems. Doing so prepares press relations specialists for public and news media inquiries and helps them to respond promptly and accurately. Examiners should update OCC managers of potential bank requests and the necessary approvals. In a liquidity crisis, timing is critical, and decision makers may need to review and approve transaction requests (e.g., divestiture proposals, strategic initiatives, or transactions with affiliates) quickly.

For banks that are in critically deficient condition and for banks that may fail, the FDIC's review and approval of material bank transactions is necessary to help ensure there will be no undue loss to the DIF. Liquidity problems require close coordination with other regulators. Examiners may need to discuss the bank's condition with the staff from the appropriate Federal Reserve Bank to determine the nature of bank assets pledged, the availability of discount window borrowing, and the holding company's ability to provide a source of strength, when applicable. If the bank has international operations, examiners may need to communicate and coordinate with applicable foreign central banks or prudential regulators.

Communication With Other Banks

In some instances, liquidity problems at one or more banks may prompt additional monitoring of, and communications with, other banks. Examiners should consult with their supervisory office and subject matter experts to determine whether broader monitoring efforts are needed to prevent or mitigate a systemic event. Such efforts may include implementing liquidity monitoring programs for affected banks or banks that are likely to incur subsequent liquidity pressure.

Prompt Corrective Action

The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term loss to the DIF.[129] 12 USC 1831o establishes a system that classifies insured depository institutions into five categories based on their regulatory capital ratios and subjects them to the respective requirements, limitations, and restrictions of those categories. The OCC's regulations implementing 12 USC 1831o are 12 CFR 6 (national banks and FSAs); 12 CFR 19, subparts M and N (national banks); and 12 CFR 165.8 and 12 CFR 165.9 (FSAs).[130]

The PCA capital categories should not be considered indications of capital adequacy under 12 CFR 3, the OCC's capital adequacy regulation. For example, a bank that is well-capitalized for the purposes of 12 CFR 6 may be found by the OCC to have inadequate capital for the purposes of 12 CFR 3. The OCC assesses capital adequacy based on the bank's risk profile relative to its risk management. Under 12 CFR 3, the OCC may require a bank to maintain higher individual minimum capital ratio(s), without regard for the bank's PCA capital category.[131]

PCA Capital Categories

12 USC 1831o establishes a framework of supervisory actions based on the capital level of a bank. The statute establishes the following five PCA capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

National Banks and Federal Savings Associations

The OCC's regulation defines the PCA capital thresholds for each capital category at 12 CFR 6.4 using the following ratios:

- Total risk-based capital (RBC) ratio
- Tier 1 RBC ratio
- Common equity tier 1 (CET1) ratio
- Leverage ratio
- Supplementary leverage ratio (SLR) for advanced approaches and category III banks only

The calculation of these ratios must be in accordance with the definitions in 12 CFR 3. Additionally, management of a bank with any ratio below the minimum capital requirements

[129] Refer to 12 USC 1831o(a)(1).

[130] 12 USC 1831o codifies section 38 of the Federal Deposit Insurance Act, which was added by section 131 of FDICIA.

[131] For more information, refer to the "Capital and Dividends" booklet of the *Comptroller's Handbook*.

in 12 CFR 3[132] should monitor the bank's tangible equity ratio to determine if the bank is critically undercapitalized.

To be well-capitalized, each of the bank's capital ratios must meet or exceed the levels set in 12 CFR 6.4. Regardless of a bank's capital level, no bank is considered well-capitalized if it is subject to any written agreement,[133] order, capital directive, or PCA directive that requires the bank to meet and maintain a specific capital level for any capital measure.[134] Banks in compliance with such agreements, orders, or directives will not be well-capitalized unless and until the agreement, order, or directive is terminated or modified to eliminate the capital requirement.

Table 1 summarizes the capital thresholds for each PCA capital category applicable to national banks and FSAs. The ratios for insured federal branches are in table 2.

Table 1: PCA Capital Category Ratios for National Banks and FSAs

	Threshold ratios				
PCA capital category	**Total RBC ratio**	**Tier 1 RBC ratio**	**CET1 RBC ratio**	**Tier 1 leverage ratio**	**SLR (advanced approaches and category III banks only)**
Well-capitalized	≥ 10%	≥ 8%	≥ 6.5%	≥ 5%	≥ 6% (eSLR)[a]
Adequately capitalized	≥ 8%	≥ 6%	≥ 4.5%	≥ 4%	≥ 3%
Undercapitalized	< 8%	< 6%	< 4.5%	< 4%	< 3%
Significantly undercapitalized	< 6%	< 4%	< 3%	< 3%	
Critically undercapitalized	Tangible equity to total assets ≤ 2% Tangible equity means the amount of tier 1 capital, as calculated in accordance with 12 CFR 3, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital. Total assets means quarterly average total assets as reported on the bank's call report. The OCC reserves the right to require a bank to compute and maintain its tangible equity ratio on the basis of actual, rather than average, total assets. Refer to 12 CFR 6.2.				

[a] The 6 percent enhanced supplementary ratio (eSLR) threshold applies only to covered insured depository institutions that are part of banking organizations with total consolidated assets of more than $700 billion, or total assets under custody of more than $10 trillion. 12 CFR 6.4(b)(1)(i)(D)(*2*).

[132] The minimum requirements in 12 CFR 3 align with the definition of "adequately capitalized" in 12 CFR 6.4.

[133] Written agreement means those agreements that are considered formal enforcement actions. For more information, refer to PPM 5310-3.

[134] This includes such agreements, orders, or directives issued by the OCC or the former Office of Thrift Supervision pursuant to section 8 of the Federal Deposit Insurance Act, the International Lending Supervision Act of 1983 (12 USC 3907), the Home Owners' Loan Act (12 USC 1464(t)(6)(A)(ii)), section 38 of the Federal Deposit Insurance Act (12 USC 1831o), or any regulation thereunder.

Community Bank Leverage Ratio

The community bank leverage ratio framework is a simple alternative methodology to measure capital adequacy for qualifying community banking organizations. A qualifying community banking organization that opts into the community bank leverage ratio framework and maintains a tier 1 leverage ratio[135] greater than 9 percent is considered to have met the minimum capital requirements, the capital ratio requirements for the well-capitalized category under the PCA framework,[136] and any other capital or leverage requirements to which the qualifying community banking organization is subject.

For banks that elect to use the community bank leverage ratio framework but no longer meet all of the qualifying criteria, there is a two-quarter grace period, during which a bank can continue to use the community bank leverage ratio framework if it maintains a leverage ratio greater than 8 percent. The grace period provides banks time to return to compliance with the qualifying criteria or move to the generally applicable capital rule. During this two-quarter period, a bank with a leverage ratio that is greater than 8 percent is still considered to have met the well-capitalized requirements for PCA purposes. If the bank's leverage ratio falls to 8 percent or less, it is no longer eligible for the grace period and must comply with the generally applicable capital rule immediately and file regulatory reports consistent with the generally applicable capital rule as of the quarter in which it would report a leverage ratio of 8 percent or less.[137]

Insured Federal Branches

Insured federal branches of foreign banking organizations are not subject to the minimum capital requirements applicable to insured national banks. Instead, the OCC requires insured federal branches to comply with the FDIC's regulations governing pledge of assets and the level of eligible assets to determine the insured federal branch's PCA capital category.[138]

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[135] The tier 1 leverage ratio is calculated by dividing tier 1 capital by average total consolidated assets.

[136] Qualifying community banking organizations that are subject to any written agreement, order, capital directive, or, as applicable, prompt corrective action directive, to meet and maintain a specific capital level for any capital measure, are still eligible to elect the community bank leverage ratio framework but are not considered well-capitalized for purposes of PCA.

[137] For information regarding temporary changes relating to the community bank leverage ratio, refer to OCC Bulletin 2020-89, "Regulatory Capital Rule: Temporary Changes to and Transition for the Community Bank Leverage Ratio Framework: Final Rule," and OCC Bulletin 2020-107, "Temporary Asset Thresholds: Interim Final Rule."

[138] Refer to 12 CFR 6.4(c), 12 CFR 347, and the "Federal Branches and Agencies Supervision" booklet of the *Comptroller's Handbook*.

Table 2: PCA Capital Category Ratios for Insured Federal Branches

PCA capital category	Summary of requirements	Reference
Well-capitalized	• Maintains the pledge of assets required under 12 CFR 347.209, and • Maintains the eligible assets prescribed under 12 CFR 347.210 at 108 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities, and • Has not received written notification from – the OCC to increase its capital equivalency deposit pursuant to 12 CFR 28.15, or to comply with asset maintenance requirements pursuant to 12 CFR 28.20. – the FDIC to pledge additional assets pursuant to 12 CFR 347.209 or to maintain a higher ratio of eligible assets pursuant to 12 CFR 347.210.	12 CFR 6.4(c)(1)
Adequately capitalized	• Maintains the pledge of assets prescribed under 12 CFR 347.209, • Maintains the eligible assets prescribed under 12 CFR 347.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities, and • Does not meet the definition of a well-capitalized insured federal branch.	12 CFR 6.4(c)(2)
Undercapitalized	• Fails to maintain the pledge of assets required under 12 CFR 347.209, or • Fails to maintain the eligible assets prescribed under 12 CFR 347.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.	12 CFR 6.4(c)(3)
Significantly undercapitalized	• Fails to maintain the eligible assets prescribed under 12 CFR 347.210 at 104 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.	12 CFR 6.4(c)(4)
Critically undercapitalized	• Fails to maintain the eligible assets prescribed under 12 CFR 347.210 at 102 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.	12 CFR 6.4(c)(5)

Notification of Capital Category

Bank management should monitor the bank's capital levels to remain aware of the bank's PCA capital category. Management of a bank that operates with capital levels at or near the regulatory minimums in 12 CFR 3 should be attentive to the impact of the bank's operations on capital ratios to avoid becoming subject to restrictions and requirements applicable to undercapitalized, significantly undercapitalized, or critically undercapitalized banks.[139] As such, management of banks operating near the regulatory minimums should generally engage

[139] Refer to 12 CFR 6.6.

in more frequent monitoring of the bank's capital ratios than a bank that is well-capitalized under PCA.

A bank becomes subject to the mandatory restrictions applicable to a given PCA capital category as of the date it is notified of, or is deemed to have notice of, its PCA capital category. Under 12 CFR 6.3(b), a bank is deemed to be notified of its capital levels and its PCA capital category as of the most recent of the following dates:

- A call report is required to be filed with the OCC.
- A final ROE is delivered to the bank.
- The OCC provides written notice to the bank
  - of the bank's PCA capital category, or
  - that the bank's PCA capital category has changed pursuant to 12 CFR 6.3(c) or 12 CFR 6.4(e), 12 CFR 19, subpart M (national banks), or 12 CFR 165.8 (FSAs).

When the OCC determines, through an examination or otherwise, that a bank's PCA capital category has changed, the appropriate OCC supervisory office must notify the bank of that determination in writing.

If a material event occurs between call report periods that would cause the bank to be placed in a lower PCA capital category, the bank must notify the OCC that the bank's PCA capital category may have changed. Examples of a material event include accounting adjustments resulting from an external audit, a large operating loss, or provision to the ALLL or ACL. The bank must inform the appropriate OCC supervisory office in writing of the details of the change within 15 calendar days of the material event. The supervisory office must review the bank's submission and determine whether to change the bank's PCA capital category and notify the bank of the OCC's determination.[140]

If a bank's capital ratio(s) improve between call report periods, the bank may request that the OCC reassess the bank's PCA capital category. Movement into a higher PCA capital category is not automatic and occurs only if the OCC concurs.

Moreover, a bank that incorrectly reports its financial condition in its call report by deferring losses or by failing to make sufficient provisions to its ALLL or ACL violates 12 USC 161 (national banks) or 12 USC 1464(v) (FSAs). Such violations may subject the bank or its IAPs to enforcement actions, including CMPs.

Reclassification Based on Unsafe or Unsound Condition or Practice

The OCC may, under certain circumstances, reclassify a well-capitalized bank as adequately capitalized. In addition, the OCC may require an adequately capitalized or undercapitalized bank to comply with the supervisory provisions applicable to banks in the next lower capital category if the bank is in an unsafe or unsound condition or engaged in an unsafe or unsound practice.

[140] Refer to 12 CFR 6.3(c).

A bank may be reclassified if the OCC determines, after notice and opportunity for an informal agency hearing, that the bank is in an unsafe or unsound condition or is engaged in an unsafe or unsound practice.[141] A bank may be deemed to be engaged in an unsafe or unsound practice if the bank has received a less-than-satisfactory rating in its most recent ROE for asset quality, management, earnings, or liquidity and the bank has not corrected the deficiency.[142]

The supervisory office, together with assigned legal staff, is typically responsible for presenting recommendations regarding PCA reclassifications to the appropriate supervision review committee.[143] The appropriate senior deputy comptroller must approve sending a notice of intent to reclassify, although the notice of intent is sent by the supervisory office.

Notice of Intent to Reclassify

The OCC must provide a bank with prior written notice of intent by the OCC to reclassify. A notice of intent to reclassify must include the following:

- The reasons for the proposed reclassification.
- A statement of the bank's capital ratios and capital levels and the category to which the bank would be reclassified.
- The date by which the bank may respond and request an informal hearing.

The bank's response and request for an informal hearing must be made within 14 days of receiving notice of the intent to reclassify, unless the OCC specifies a different time frame. The OCC may shorten the period for response if it determines that a shorter time period is appropriate in light of the financial condition of the bank or other relevant circumstances. Failure to respond within the specified time period constitutes a bank's waiver of its opportunity to respond and constitutes consent to the reclassification.[144]

Informal Hearing

The bank has the right to an informal OCC hearing on the proposed reclassification. The bank has the right to introduce relevant written materials and to present oral argument at the hearing. In its request for a hearing, the bank must include any request to present oral testimony or witnesses at the hearing and must list the names of witnesses and the general nature of their expected testimony. The bank may introduce oral testimony and present witnesses only if authorized by the OCC or the presiding officer.

[141] Refer to 12 CFR 19.221 (national banks) and 12 CFR 165.8 (FSAs).

[142] Refer to 12 USC 1818(b)(8).

[143] For more information, refer to the "Supervision Review Committees" section of PPM 5310-3.

[144] Refer to 12 CFR 19.221(b) (national banks) and 12 CFR 165.8(a)(2) (FSAs).

After receiving a timely written request for an informal hearing the OCC must issue an order directing that the hearing commence within 30 days of the request. The OCC may allow additional time if requested by the bank.[145]

An OCC official not involved in the initial recommendation to reclassify the bank must serve as the presiding officer conducting the hearing. Within 20 days after the informal hearing, the presiding official must make a reclassification recommendation to the appropriate senior deputy comptroller.[146] The OCC's final decision on whether to reclassify the bank must be issued within 60 calendar days after the hearing record is closed, or the date of the response in a case where no hearing was requested.[147]

Restrictions Applicable to Reclassified Banks

A well-capitalized bank that is reclassified as adequately capitalized is not subject to any additional restrictions under 12 USC 1831o. Other restrictions or requirements, however, may apply to such reclassified banks.

The OCC may require an adequately capitalized or undercapitalized bank to comply with one or more of the provisions applicable to banks in the next lower capital category (except the requirement to file a CRP). The mandatory restrictions that apply without any action by the OCC to undercapitalized and significantly undercapitalized banks, however, do not automatically apply to reclassified banks. Such restrictions only apply if ordered by the OCC. For example, an adequately capitalized bank that is reclassified as undercapitalized may be prohibited from making capital distributions or subjected to asset growth restrictions, but only if the OCC expressly orders it. Other restrictions or requirements may also apply to some reclassified banks.

Prohibition on Disclosure of Capital Category

Banks are prohibited from disclosing their PCA capital categories in advertisements or promotional materials, unless such disclosure is required by law or authorized by the OCC.[148]

The OCC recognizes that disclosure of a bank's capital category may be appropriate in certain circumstances and under certain conditions. For example, disclosure of the bank's PCA capital category, and related material regulatory restrictions, may be required under federal securities and banking laws in a bank's securities filings or in annual or quarterly reports. The restriction on disclosure in advertising is not intended to prohibit a bank from disclosing its PCA capital category in response to inquiries from investors, customers, or

[145] Refer to 12 CFR 19.221(f) (national banks) and 12 CFR 165.8(a)(6) (FSAs).

[146] Refer to 12 CFR 19.221(h) (national banks) and 12 CFR 165.8(a)(8) (FSAs).

[147] Refer to 12 CFR 19.221(i) (national banks) and 12 CFR 165.8(a)(9) (FSAs).

[148] Refer to 12 CFR 6.1(e).

other third parties as long as the bank also provides appropriate caveats regarding the PCA capital category. A bank that discloses its PCA capital category to the public (e.g., in a securities filing, in an annual report, or in response to an inquiry) should also disclose that the bank's capital category is determined solely for the purposes of applying PCA and that the PCA capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

If a bank discloses its PCA capital category, and the capital category subsequently changes, the bank may have an obligation to disclose the change. In addition, management or the board of a bank that believes materially false or misleading information relating to the bank's PCA capital category exists in the marketplace should consider whether the bank has an obligation to correct the information under applicable federal securities and banking law.

PCA Restrictions

Banks in each PCA capital category are subject to certain statutorily prescribed restrictions. The restrictions become increasingly severe as the bank moves downward through each successive PCA capital category. Some of the restrictions are mandatory and apply without any action by the OCC when a bank is notified of its capital category. Other restrictions may be imposed by the OCC by issuance of a PCA directive.

A bank may be subject to other restrictions or requirements based on the bank's PCA capital category, for example, restrictions on brokered deposits,[149] prohibition from accepting employee benefit plan deposits,[150] limits on exposure to interbank liabilities,[151] and risk-based deposit assessment.[152] Some of these statutes and regulations use definitions of the capital categories are that are different from the definitions in 12 USC 1831o. Banks and OCC supervisory offices should refer to the relevant statute and regulation to determine the appropriate capital category for each restriction. Table 3 summarizes PCA restrictions for each PCA capital category. For more information, refer to the sections following the table.

Table 3: Summary of Applicable PCA Provisions by PCA Capital Category

PCA category	Applicable PCA provisions
Well-capitalized or adequately capitalized	The bank must not make a capital distribution or pay management fees if the bank would be undercapitalized after making such distributions or paying such fees.

[149] Refer to 12 USC 1831f, 12 CFR 303.243, 12 CFR 337.6, 12 CFR 337.7, and FDIC FIL-42-2016. Deposit rate restrictions prevent a bank that is not well-capitalized from circumventing the prohibition on brokered deposits by offering rates significantly above market to attract a large volume of deposits quickly. Generally, a bank that is not well-capitalized may not offer deposit rates that exceed the higher of the national rate plus 75 basis points or 120 percent of the current yield on similar U.S. Treasury obligations or federal funds rate plus 75 basis points.

[150] Refer to 12 USC 1821(a)(1)(D).

[151] Refer to 12 USC 371b-2 and 12 CFR 206.

[152] Refer to 12 USC 1817(b)(1)(C) and 12 CFR 327.

PCA category	Applicable PCA provisions
Undercapitalized	Same as adequately capitalized banks, plus • restrictions on asset growth, acquisitions, new branches, and new lines of business. • the bank must submit an acceptable CRP to the OCC within 45 days of the date the bank was notified of its undercapitalized status, unless the OCC specifies a different time frame. • discretionary application of certain restrictions otherwise applicable only to significantly undercapitalized banks.
Significantly undercapitalized banks and undercapitalized banks that have failed to submit an acceptable CRP	Same as undercapitalized banks, plus • restrictions on senior executive officer compensation. The OCC must also take one or more of the following actions: • Require recapitalization. • Restrict affiliate transactions. • Restrict interest rates on deposits. • Further restrict asset growth or require the bank to reduce assets. • Require the bank to alter, reduce, or terminate activities. • Require the bank to improve management by electing new directors, dismissing directors or senior executive officers, or requiring qualified senior executive officers. • Prohibit the bank's acceptance of deposits from correspondent banks. • Require certain divestitures of subsidiaries. • Require the bank to take any other action the OCC determines will resolve the bank's problems at the least possible long-term cost to the DIF more effectively than any of the actions described here.
Critically undercapitalized	Same as significantly undercapitalized banks and undercapitalized banks that have failed to submit and implement an acceptable CRP, plus • receivership or conservatorship within 90 days, or such other action the OCC determines, with the concurrence of the FDIC, would better achieve the purposes of PCA. • restrictions on payments of principal or interest on the bank's subordinated debt. The FDIC must also prescribe certain further restrictions on the activities of the bank.

All Banks

Pursuant to 12 USC 1831o(d), banks of any PCA capital category are prohibited from making any capital distribution[153] to shareholders or paying any management fee[154] to any person with control[155] over the bank if after making the distribution or paying the fee, the bank would be undercapitalized. This prohibition means that no undercapitalized, significantly undercapitalized, or critically undercapitalized bank may make any capital distribution to shareholders or pay any management fee to a controlling person.

[153] Refer to 12 USC 1831o(b)(2)(B).

[154] Refer to 12 CFR 6.2. The definition of "management fee" does not include payments such as those for electronic data processing, trust activities, mortgage servicing, audit or accounting services, property management, or similar service fees.

[155] Refer to 12 USC 1841.

A limited exception to the prohibition on capital distributions is provided for stock redemptions. Under 12 USC 1831o(d)(1)(B), the OCC, after consulting with the FDIC, may permit a bank to repurchase, redeem, retire, or otherwise acquire shares or ownership interests if the repurchase, redemption, retirement, or other acquisition

- is made in connection with the issuance of additional shares or obligations of the institution in at least an equivalent amount; and
- will reduce the institution's financial obligations or otherwise improve the institution's financial condition.

PCA Requirements for Undercapitalized Banks

Undercapitalized banks are subject to mandatory requirements and may be subject to discretionary requirements. Mandatory requirements apply by operation of law without any action by the OCC. The following are the mandatory requirements:

- Restrictions on asset growth, acquisitions, new branches, and new lines of business.
- The bank must submit an acceptable CRP to the OCC within 45 days of the date the bank was notified of its undercapitalized status, unless the OCC specifies a different time frame.

The OCC may impose any of the discretionary restrictions applicable to significantly undercapitalized banks by issuance of a PCA directive, if the OCC determines that such actions are necessary to help resolve the problems of the bank at the least possible long-term cost to the DIF. For more information, refer to the "Restrictions for Significantly Undercapitalized Banks and Certain Undercapitalized Banks" section of this booklet.

Restrictions on Asset Growth and Expansion of Activities

An undercapitalized bank's average total assets during any calendar quarter must not exceed its average total assets during the preceding quarter unless

- the OCC has approved its CRP.
- the increase in total assets is consistent with the approved CRP.
- the bank's ratio of tangible equity to assets increases during the calendar quarter at a rate sufficient to enable it to become adequately capitalized within a reasonable time.

Each undercapitalized bank must secure the prior written approval of the OCC[156] to acquire an interest in any company or insured depository institution, establish or acquire any additional branch office, or engage in any new line of business (collectively, expansion of activities). The OCC cannot approve expansion of activities unless the bank is operating under an approved CRP.[157]

[156] Refer to 12 USC 1831o(e)(4)(B).

[157] Refer to 12 USC 1831o(e)(4)(A).

Monitoring Undercapitalized Banks

The OCC must

- closely monitor the condition of the bank.
- closely monitor compliance with restrictions and requirements imposed under PCA.
- closely monitor compliance with the CRP.
- periodically determine whether the restrictions, requirements, and CRP are achieving the purpose of PCA.

The OCC should conduct these activities at least quarterly, unless the supervisory office determines that another review schedule will provide sufficiently close monitoring. The bank's portfolio manager or EIC is generally responsible for monitoring the bank's financial condition each quarter using call reports and other relevant information provided by the bank. The examiner should document the results of each quarter's review and discuss the need for any additional action with the supervisory office.

Restrictions for Significantly Undercapitalized Banks and Certain Undercapitalized Banks

Significantly undercapitalized banks are subject to the mandatory restrictions applicable to undercapitalized banks, plus restrictions on senior executive officer compensation. These restrictions also apply to undercapitalized banks that have failed to submit or implement, in any material respect, an acceptable CRP.

If a significantly undercapitalized bank has already submitted an acceptable CRP, the supervisory office should review the CRP and determine whether to require a new or revised CRP. Refer to table 3 in the "PCA Restrictions" section of this booklet for a summary of the mandatory and discretionary requirements.

Additionally, the OCC generally must take one or more discretionary actions, as indicated in the "Discretionary Actions" section of this booklet.

Restrictions on Senior Executive Officer Compensation

Significantly undercapitalized banks and undercapitalized banks that have failed to submit or implement in any material respect an acceptable CRP are required to obtain the OCC's prior written approval before paying any bonus or increasing the compensation to any senior executive officer.[158] If the bank has not submitted an acceptable CRP, the OCC cannot approve such a request.

[158] Banks may have additional obligations under 12 CFR 359. Requesting approval for paying a bonus or increasing compensation of a senior executive officer for PCA purposes does not fulfill the bank's obligations under 12 CFR 359.

Discretionary Actions

12 USC 1831o directs the OCC to take at least one of the following actions against each significantly undercapitalized bank, and against each undercapitalized bank that fails to submit or implement an acceptable CRP.[159] While these actions are generally discretionary, 12 USC 1831o presumes that the OCC will take the first three actions listed below unless the OCC determines the actions would not further the purposes of PCA.[160]

- Require recapitalization through one or more of the following:
  - Requiring the sale of enough shares or obligations of the bank so that the bank will be adequately capitalized after the sale. The OCC may further require that instruments sold be voting shares.
  - Requiring the bank to be acquired by a depository institution holding company, or to combine with another insured depository institution, if one or more grounds exist for appointing a conservator or receiver for the institution.[161]
- Restrict transactions with affiliates by requiring the bank to comply with 12 USC 371c as if the exemption in 12 USC 371c(d)(1) did not apply (commonly referred to as the "sister bank exemption"). The OCC may also further restrict the bank's transactions with affiliates.
- Restrict interest rates paid on the bank's deposits to the prevailing rates in the region where the bank is located, as determined by the OCC. The OCC cannot retroactively restrict interest rates paid on time deposits made before the OCC imposed the interest rate restriction under 12 USC 1831o(f)(2)(C)(i).
- Further restrict the bank's asset growth or require the bank to reduce its total assets.
- Restrict activities by requiring the bank or its subsidiaries to alter, reduce, or terminate any activity that the OCC determines poses excessive risk to the bank.
- Improve management through one or more of the following:
  - Ordering a new election for the bank's board.
  - Requiring the bank to dismiss directors or senior executive officers who held office for more than 180 days immediately before the institution became undercapitalized. Dismissal under PCA does not constitute a removal action under 12 USC 1818.
  - Requiring the bank to employ qualified senior executive officers, who, if the agency so specifies, are subject to OCC approval.[162]
- Prohibit the bank from accepting deposits from correspondent banks, including renewals and rollovers of prior deposits.
- Require the bank to divest itself of or liquidate any subsidiary if the OCC determines that the subsidiary is in danger of becoming insolvent and poses a significant risk to the bank

[159] Refer to 12 USC 1831o(f)(2).

[160] Refer to 12 USC 1831o(f)(3).

[161] For more information regarding receivership or conservatorship grounds, refer to 12 USC 1821(c)(5) (national banks and FSAs), 12 USC 191 (national banks), 12 CFR 203 (national banks and FSAs), and 12 USC 1464(d)(2) (FSAs).

[162] Separate notice and OCC review may be required under 12 CFR 5.51. For more information, refer to the "Changes in Directors and Senior Executive Officers" booklet of the *Comptroller's Licensing Manual*.

or is likely to cause significant dissipation of the bank's assets or earnings. The OCC must consult with other regulators when such an affiliate is a broker, dealer, government securities broker, investment company, or investment adviser, or if the affiliate is subject to any financial responsibility or capital requirement of another regulator.[163]
- Require the bank to take other action(s) that the OCC determines will better carry out the purpose of PCA.

There are additional discretionary actions that can be taken against parent companies and affiliates by the appropriate federal banking agency, generally, the Federal Reserve.[164] If the OCC determines that such actions would improve the bank's condition, the supervisory office should contact the Federal Reserve or appropriate Federal Reserve Bank.

PCA Restrictions for Critically Undercapitalized Banks

Critically undercapitalized banks are subject to all the mandatory and discretionary restrictions applicable to significantly undercapitalized banks. Critically undercapitalized banks are also subject to several additional actions, including

- receivership or conservatorship within 90 days, or such other action that the OCC determines, with the concurrence of the FDIC, would better achieve the purpose of PCA.
- restrictions on payments of principal or interest on the bank's subordinated debt.

In addition to these actions, the FDIC may, by regulation or order, restrict the activities of a critically undercapitalized bank. For more information, refer to the "FDIC Restrictions on Activities" section of this booklet.

Appointment of Receiver or Conservator

Critically undercapitalized banks are required to be placed in receivership or conservatorship within 90 days of becoming critically undercapitalized unless the OCC and FDIC agree that another action would better achieve the purposes of PCA. Except in rare circumstances, the OCC appoints the FDIC as receiver within 90 days of a bank becoming critically undercapitalized. In rare cases, the OCC may consider appointing a conservator instead of a receiver. The FDIC must agree in writing before a conservator, rather than a receiver, can be appointed.[165]

If the OCC determines that a bank should not be placed into receivership or conservatorship, the OCC must document the reasons an alternative action would better serve the purpose of PCA and receive the FDIC's concurrence to take the alternative action. If the FDIC concurs, no receiver or conservator need be appointed within 90 days of the bank becoming critically undercapitalized. The determination to defer placing a bank in receivership or

[163] Refer to 12 USC 1831o(f)(6).

[164] Refer to 12 USC 1831o(f)(2)(H) and (I)(ii)-(iii).

[165] For more information about receivership, refer to the "Receivership" section of this booklet.

conservatorship must be reviewed every 90 days. If the alternative action fails to restore capital, the OCC is required to appoint a receiver if the institution is critically undercapitalized on average during the calendar quarter beginning 270 days after the date on which the bank became critically undercapitalized. A limited exception to this requirement is possible when all of the following conditions are met:

- The OCC determines and the FDIC concurs that
  - the bank has positive net worth.
  - the bank has been in substantial compliance with an approved CRP that has required consistent improvement in the bank's capital since the approval date.
  - the bank is profitable or has an upward trend in earnings that the OCC projects as sustainable.
  - the bank is reducing its ratio of nonperforming loans to total loans.
- The Comptroller of the Currency and the FDIC Chair certify, in writing, that the bank is viable and is not expected to fail.

Restriction on Payment of Subordinated Debt

Critically undercapitalized banks are also prohibited from making any payments of principal or interest on the bank's subordinated debt (without the FDIC's prior approval) beginning 60 days after becoming critically undercapitalized.

FDIC Restrictions on Activities

Unless given prior FDIC written approval, critically undercapitalized banks are prohibited from[166]

- entering into any material transaction, other than in the usual course of business, that would normally require prior notice to the OCC.
- extending credit for any highly leveraged transaction.
- amending the bank's charter or bylaws, except to the extent necessary to carry out any other requirements of law, regulation, or order.
- making any material change in accounting methods.
- engaging in any covered transaction, as that term is defined in 12 USC 371c(b)(7).
- paying excessive compensation or bonuses.
- paying rates of interest on new or renewed liabilities at a rate that would increase the bank's weighted average cost of funds to a level significantly above the prevailing rates of interest on insured deposits in the bank's normal market areas.

Capital Restoration Plans

A bank must submit a CRP to the supervisory office within 45 days after the bank has notice, or is deemed to have notice, that it is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the OCC specifies a different time frame. If a bank is

[166] Refer to 12 USC 1831o(i)(2).

operating under an approved CRP and its capital category changes, it must file a new or revised CRP only when required by the OCC in writing.

To prepare an acceptable CRP, the board and management should analyze the current condition and future prospects of the bank to determine the most efficient and expedient way to return the bank to the adequately capitalized PCA capital category. The bank's CRP should fully document the results of that analysis. Elements of this analysis should include current and pro forma balance sheets, current and long-term budgets, a strategic plan for the bank, the market analysis used to derive the appropriate means to raise capital, and any other relevant information. The CRP should clearly detail the assumptions used in the analysis.

The CRP must address[167]

- the steps the bank will take to become adequately capitalized.
- the levels of capital to be attained during each year of the plan.
- the types and levels of activities in which the bank will engage.
- how the bank will comply with the restrictions against asset growth (see 12 USC 1831o(e)(3)) and acquisitions, branching, and new lines of business (see 12 USC 1831o(e)(4)).
- Any other information required by the OCC.

Capital plans required under 12 CFR 3, subparts J and H, do not automatically constitute CRPs required under PCA. A capital plan submitted under 12 CFR 3 is not acceptable as a CRP unless it addresses statutory requirements in 12 USC 1831o(e).

Guarantee of Capital Restoration Plan by Controlling Company

The OCC cannot approve any CRP unless each company that controls the bank guarantees that the bank will comply with the CRP. The purpose of the guarantee is for the controlling company to provide a financial commitment; the controlling company must provide appropriate assurances of performance to the OCC that the company's subsidiary bank will comply with the CRP.

The company's aggregate liability under the guarantee is limited to the lesser of the following:

- Five percent of the bank's total assets at the time the bank became undercapitalized.
- The amount necessary to restore the bank's capital to the applicable minimum capital levels as those levels were defined at the time that the bank initially failed to comply with its CRP.

[167] Ibid.

The guarantee and limit of liability expire after the OCC notifies the bank in writing that the bank has remained adequately capitalized for four consecutive calendar quarters.[168] The expiration of a guarantee given by a company or fulfillment of a guarantee given by a company in connection with one CRP does not relieve the company from an obligation to guarantee another CRP at a future date for the same bank if the bank again becomes undercapitalized. Fulfillment of one guarantee up to the statutory limit would not reduce the amount of any guarantee of a future CRP for the same bank. In addition, a new or revised guarantee is required if the bank is required to submit a new or revised CRP.

Each company controlling a given bank is jointly and severally liable for the amounts needed to recapitalize the bank. The OCC may direct the bank to seek payment of the full amount of the guarantee from any or all of the companies issuing the guarantee.

Content of Guarantee

In general, the guarantee should provide the controlling company's financial commitment guaranteeing the bank's compliance with the CRP. In addition, the guarantee may include assurances that the company will take actions required by the CRP, for example, (1) ensuring that competent management will be selected, (2) restricting transactions between the bank and the company, and (3) discontinuing certain risky or inappropriate bank or affiliate activities.

Depending on the company involved, other assurances of performance may be appropriate, such as a promissory note, a pledge of controlling company assets, legal opinions from controlling company counsel, or a controlling company board of director's resolution.

Appendix C of this booklet contains a sample guarantee companies may use when guaranteeing CRPs to assure performance. The sample guarantee

- references the parties to the guarantee (the bank and the guarantor holding company(s)).
- incorporates by reference the CRP submitted for approval by the bank.
- provides that the holding company unconditionally guarantees and provides a financial commitment that the bank will comply with its CRP.
- provides that the holding company will
  - take any action directly required under the CRP;
  - take any corporate actions necessary to enable the bank to take actions required of the bank under the CRP;
  - not take any action that would impede the bank's ability to implement its CRP;
  - ensure that the bank is staffed by competent management; and
  - restrict transactions between the holding company and the bank.
- states the limit of liability and the promise to pay the amount described.
- incorporates by reference a certified resolution of the board of the holding company regarding the guarantee.
- describes the consideration provided, and certain rights of the parties.

[168] Refer to 12 CFR 6.5(i)(1)(ii).

- provides for the pledge of holding company assets, or other appropriate collateral, to secure the guarantee, when deemed appropriate.
- includes certain other provisions such as a statement on governing law.

The guarantee is patterned after a standard commercial guarantee. It requires the controlling company to perform on its guarantee when the bank notifies the company that the bank has failed to comply with its CRP. If the bank declines or delays in enforcing the guarantee, the OCC may take action directing the bank to enforce the guarantee or take any other action under 12 USC 1831o or 12 USC 1818 as may be appropriate. In the event the bank is placed in receivership, the FDIC as receiver would be entitled to the proceeds of any contribution by the controlling company.

Pledge of Controlling Company Assets

12 USC 1831o(e)(2)(C)(ii)(II) states that each company having control over the bank must provide "appropriate assurances of performance" to satisfy the guarantee requirement. These assurances vary on a case-by-case basis depending on the bank's condition and willingness to implement changes, the strength of the controlling company, and other relevant factors.

In the case of a cooperative, strong company controlling an undercapitalized bank, the OCC generally requires only a written guarantee from the company along with a copy of its audited financial statements.

In other cases, a pledge of certain nonbanking assets may be required. For example, the OCC typically requires a financially weak company that controls an undercapitalized bank to pledge assets to secure its guarantee. Similarly, the OCC typically requires a company that controls a significantly or critically undercapitalized bank to pledge assets regardless of its financial strength. The OCC may also require a security agreement and a Uniform Commercial Code (UCC)-1 financing statement if a controlling company pledges assets to secure the guarantee.

In addition, if the pledged assets are not of a type that a bank can legally hold, to the extent permissible under applicable law, the pledge agreement and other relevant documents must not prevent or inhibit the bank from liquidating such assets following contribution of those assets to the bank.

The need for a pledge depends on the organizational structure of the controlling company. In a multitiered company structure, each controlling company is jointly and severally liable for implementation of the bank's CRP. For the bank's CRP to be acceptable, each company must guarantee the CRP and provide adequate assurances of performance. Intermediate shell holding companies may, however, rely on the financial resources of the parent company or of a third party as adequate assurance of performance on the guarantee.

In the case of a controlling shell company or a company that has limited resources, a guarantee is required for the bank's CRP to be acceptable. Given the company's lack of resources, however, a pledge of assets is not generally required. Instead, the OCC evaluates

the CRP on the same basis that it evaluates plans submitted by banks owned by individuals. If the OCC would approve a CRP submitted by a bank owned by an individual, it will approve a similar CRP submitted by a bank owned by a shell company.

OCC Review of Capital Restoration Plan and Controlling Company Guarantees

The OCC does not accept a CRP unless the plan contains the information required by statute, is based on realistic assumptions, is likely to succeed in restoring the bank's capital, and will not increase the risk to the bank. In addition, the OCC does not accept a CRP that is not guaranteed by the company or companies that control the bank.

The OCC determines, on a case-by-case basis, the adequacy of guarantees and assurances of performance by the bank's controlling company. The OCC supervisory office may consult with the Federal Reserve or appropriate Federal Reserve Bank to discuss provisions of the guarantee. The OCC may also consult with the FDIC on the terms of the guarantee to ensure that the FDIC's interest as receiver would be protected if the bank is later placed in receivership. The OCC may request that the bank and the controlling company obtain a legal opinion from the bank's or company's counsel that the guarantee and any pledge of assets securing such guarantee, if applicable, constitute a legally binding commitment against the company that is given in the ordinary course of business for adequate consideration.

The OCC generally must notify the bank in writing of the CRP's approval within 60 days of receipt or must notify the bank in writing of the delay and the reason for the delay. The OCC supervisory office must submit a copy of each approved CRP to the FDIC's regional office within 45 days of approval.

In reviewing the bank's CRP, the OCC assesses the bank's viability, including an assessment of whether grounds exist for the appointment of a receiver. Refer to the "Grounds for Receivership" section of this booklet for a list of the grounds for appointment of a receiver or conservator.[169]

PCA Directives

The OCC imposes the discretionary actions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks by issuing a PCA directive. Refer to PPM 5310-3 for the OCC's enforcement action procedures, including procedures applicable to issuing a PCA directive.

A PCA directive is enforceable as a final order in federal district court in the same manner and to the same extent as a final cease-and-desist order. CMPs may be assessed for violating a PCA directive.

[169] Refer to 12 USC 1821(c)(5) (national banks and FSAs), 12 USC 191 (national banks), and 12 USC 1464(d)(2) (FSAs).

Problem Bank Resolution

This section of the booklet only applies to FDIC-insured banks. For uninsured banks, refer to 12 CFR 51, "Receiverships for Uninsured National Banks." For uninsured federal branches and agencies, refer to 12 USC 3102(j), "Receivership Over Assets of Foreign Bank in United States."

The OCC plans for resolution if a bank's viability is doubtful, including when the bank's condition or management and the board's actions warrant consideration of receivership or conservatorship. This does not mean that the bank is certain to fail—the OCC considers any reasonable opportunity for the bank to correct its deficiencies and avoid closure to prevent a loss to the DIF—but the OCC must prepare for a potential bank failure.

In lieu of receivership or conservatorship, the OCC in some circumstances may require a bank to sell, merge, or liquidate. Under PCA, if a bank is significantly undercapitalized or is undercapitalized and has failed to submit and implement a CRP, the OCC may require the sale or merger of the bank, if one or more grounds exist for appointing a receiver.[170] The OCC can discuss sale, merger, or liquidation as a viable resolution strategy with problem banks irrespective of their capital position.

When a bank becomes undercapitalized or when a bank begins to show deficiencies indicated in the receivership grounds but is not yet critically undercapitalized, examiners should consider whether a resolution plan involving sale, merger, liquidation, or receivership is appropriate. This could be the case, for example, when a bank has reached the point where additional enforcement action or PCA restrictions are unlikely to prevent deterioration or reduce costs to the DIF. Once a decision is made to adopt a resolution approach, OCC resources should focus on the best option to avoid a loss to the DIF.

The Special Supervision Division supervises the resolution of critical problem banks through orderly resolution management. This section provides an overview of the supervision of banks with an increased likelihood of failure and provides an overview of the receivership process. While the primary basis for receivership typically involves significant capital depletion, this section describes the legal grounds for which the OCC can place a bank in receivership. This section highlights supervisory issues related to the loan review process, the need for a strong legal record to support receivership, the capital call meeting for significantly or critically undercapitalized banks, the bid process, legal review before closing, and the formal bank closing procedures.

Coordination With Other Regulators

Interagency coordination is an important aspect of problem bank supervision. The federal banking agencies work together to identify and reduce regulatory burden and duplication and, when appropriate, coordinate supervision and examination activities. Coordination among primary and functional regulators is a key aspect of orderly resolution of a problem

[170] Refer to 12 USC 1831o(f)(2)(A)(iii).

bank. Through these efforts, the agencies recognize each other's oversight responsibilities. The PBS assigned to a problem bank should communicate regularly with other regulators in the resolution process. The PBS, EIC, and the Special Supervision Division are responsible for coordinating interagency communication.

Consistent with their statutory mandates, the FDIC and the Federal Reserve both have important roles in problem bank supervision. The FDIC, as insurer and receiver, has numerous responsibilities for failing and failed banks. Also, 12 USC 1818(t) grants the FDIC back-up enforcement authority for certain insured banks that are in an unsafe or unsound condition or otherwise pose a risk to the DIF. Further, under 12 USC 1820(b)(3), the FDIC has special examination authority for certain insured depository institutions. Use of these powers is rare because of cooperation between the agencies; however, the FDIC may cite such authorities to seek direct participation in OCC examination activities. It is common for the FDIC to participate in examinations at all 5-rated banks and complex 4-rated banks. The Comptroller has reserved sole authority to deny such a request from the FDIC. If FDIC staff disagrees with a Comptroller denial, it must get approval from the FDIC Board to examine the bank.

The FDIC is responsible for managing receivership operations and for ensuring that failing banks are resolved at the least cost to the DIF. Whenever an FDIC-insured bank fails, the FDIC is appointed receiver and settles the affairs of the bank. This includes balancing the accounts of the bank immediately after closing, transferring assets and liabilities consistent with agreed-on resolution plans, and determining the exact amount of payment due the acquirer and depositors, if any. This responsibility necessitates significant coordination between the OCC, the FDIC, and the bank.

The Federal Reserve's supervisory interest in problem banks is premised on Federal Reserve Banks' roles as "lender of last resort" and as a holding company supervisor. Under 12 CFR 201.5, Federal Reserve Banks may only make discount window advances to undercapitalized banks for no more than 60 days in any 120-day period. A critically undercapitalized bank may receive discount window advances only during the five-day period that begins on the day the bank becomes critically undercapitalized.

Documenting Asset Quality Reviews

Because accurate classification of assets is critical to a problem bank's viability, the loan portfolio manager and EIC must review loan write-ups and examiner conclusions. For banks supervised by the Special Supervision Division, the PBS also must also independently review the write-ups. These reviews of the loan write-ups validate examination findings by confirming that asset classifications are consistent with OCC policies and procedures. For complex assets, it may be beneficial to contact OCC accounting specialists or credit risk subject matter experts to participate in the review. The review provides quality assurance and validation of the examination findings and ensures accurate charge-offs, when necessary.

Examiners should submit the following for review:

- "Summary of Items Subject to Adverse Classification/Summary of Items Listed as Special Mention" section of the ROE or supervisory letter
- Loan or other asset write-ups and supporting documentation
- Credit loss allowance analysis, conclusions, and supporting documentation.

The loan portfolio manager should submit the information for review to the EIC. Participants reviewing examiners' work should be experienced examiners who have not been directly involved in the asset quality portion of the examination. Usually, the PBS responsible for a nondelegated bank is one of the reviewers. Depending on the nature of the examination findings, types of assets classified, and bank management's response to the examination findings, the review may include additional subject matter experts at the discretion of the EIC and Director for Special Supervision.

Because capital-based closings are tied to the level of tangible equity capital, the review to validate the results of the OCC's credit loss allowance analysis is critical. The examiners should submit their review of the bank's credit loss allowance methodology, with supporting documentation, along with the recommended credit loss allowance balance and provision, to the EIC, PBS, and Director for Special Supervision. If those reviewing the examiners' conclusions disagree on the classification of specific assets or the credit loss allowance provision, other subject matter experts should advise on the outcome, and the Director for Special Supervision makes the final decision. Generally, few significant changes to classifications or required provisions occur during validations because of the extensive reviews conducted during the examination.

Receivership

The OCC has authority and responsibility to appoint the FDIC as a receiver for an OCC-supervised, FDIC-insured bank based on several grounds.[171] The OCC's goal is to resolve a bank to avoid or minimize losses to the DIF. The most commonly used grounds for receivership are related to violations of law, unsafe or unsound practices, and capital adequacy.

For a receivership based on capital insolvency or critically undercapitalized status, accurate assessment of capital is crucial. The Special Supervision Division manages capital-related failures using procedures discussed in this section. Monitoring for potential liquidity insolvency and managing liquidity failures, however, require customized procedures and monitoring.

The OCC has the authority to place a bank into receivership *before* the bank becomes critically undercapitalized if one or more of the specified receivership grounds exists. Such action may resolve a problem bank at the least cost to the DIF. Resolution before a bank

[171] There is similar authority to appoint a conservator for a bank. Refer to 12 USC 1821(c), "Appointment of Corporation as Conservator or Receiver."

becomes critically undercapitalized can reduce or limit losses that might otherwise result if the bank remains open. Early resolution can be considered, for example, when a bank is losing capital, has no realistic prospects for recapitalization, or is engaging in practices likely to increase losses. While it is rare for a bank that is adequately or well-capitalized under PCA, receivership may be appropriate if there are substantial unsafe or unsound practices, the bank has cross-guarantees with other failing banks, or there are other significant deficiencies that contribute to an OCC determination that the bank meets one or more of the statutory grounds for receivership.

Grounds for Receivership

The statutory grounds for receivership are in 12 USC 1821(c)(5). The grounds related to capital are the following:

- The bank's assets are less than the bank's obligations to its creditors and others.
- The bank has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the bank to become adequately capitalized (as defined by PCA) without federal assistance.
- The bank is undercapitalized (as defined by PCA) and
  - has no reasonable prospect of becoming adequately capitalized,
  - fails to become adequately capitalized when required to do so under PCA,
  - fails to submit a CRP acceptable to the OCC within the time period prescribed under PCA, or
  - materially fails to implement a CRP submitted and accepted under PCA.
- The bank is critically undercapitalized (as defined by PCA).
- The bank otherwise has substantially insufficient capital.

The following are grounds based on violations of law or unsafe or unsound practices or conditions that had, or are likely to have, a substantial negative effect on the bank:

- The bank is likely to be unable to pay its obligations or meet its depositors' demands in the normal course of business.
- There is substantial dissipation of assets or earnings due to any violation of statute or regulation or any unsafe or unsound practice.
- There is a violation of law or regulation, or an unsafe or unsound practice or condition, that is likely to
  - cause insolvency or substantial dissipation of assets or earnings,
  - weaken the bank's condition, or
  - otherwise seriously prejudice the interests of the bank's depositors or the DIF.
- The bank is in an unsafe or unsound condition to transact business.

Grounds based on critical corporate governance issues are the following:

- There is a willful violation of a cease-and-desist order that has become final.

- There is concealment of the bank's books, papers, records, or assets, or refusal to submit the bank's books, papers, records, or affairs for inspection to any examiner or to any lawful agent of the OCC.
- The bank, by resolution of its board or its shareholders or members, consents to the appointment.
- The bank ceases to be an insured institution.
- The U.S. Attorney General notifies the OCC in writing that the bank has been found guilty of a criminal money laundering offense.

For national banks, 12 USC 191 identifies an additional ground for receivership: the national bank's board consists of fewer than five members.[172]

The Special Supervision Division and OCC legal counsel document support for the legal basis for the receivership grounds. In most instances, prior enforcement actions or PCA restrictions would have addressed these matters at an earlier stage, before they became more severe (e.g., when the bank first became undercapitalized or was required to remedy unsafe or unsound practices). The record prepared for those actions becomes a part of documenting the receivership grounds.

Additional documentation of the continuing and worsening problems and, for some grounds, documentation of the substantial negative impact on the bank's assets, earnings, and ability to conduct business are important. The supervisory office, in coordination with assigned legal counsel, coordinates and plans the reviews and approvals necessary to support resolution. The PBS should consult with legal counsel and the Special Supervision Division regarding options available and what record is needed to support them.

Bank Closing Process

This section discusses the steps that the Special Supervision Division takes once it determines that it may recommend closing the bank. The closing process runs parallel with all plans by the board to recapitalize the bank and correct deficiencies. The Special Supervision Division discontinues the closing process at any point that it determines the bank has a viable path other than resolution.

Capital Call Meeting

The Special Supervision Division schedules a capital call meeting with the bank's board when the division determines that the bank is critically undercapitalized or has a strong likelihood of becoming critically undercapitalized. This often occurs after the OCC confirms the bank's capital category and performance trends, typically upon concluding an asset quality review. Because of the bank's potential imminent failure, the OCC does not wait to issue written communication before holding the capital call meeting. The capital call meeting signals the beginning of the closing process for a critically deficient bank; however, banks should continue to seek an open-market resolution in advance of the bank's failure.

[172] There is no similar statutory provision for FSAs.

The EIC and PBS use a capital analysis worksheet to calculate the minimum capital injection needed to restore adequate capital to the bank.[173] The EIC and PBS must prepare this worksheet before the capital call meeting and after confirming losses identified during the supervisory activity or in the bank's call report filing. The EIC and PBS use the worksheet to discuss the bank's capital needs during the capital call meeting.

Given the ramifications to the bank, the Director for Special Supervision conducts the meeting, assisted by the PBS and EIC. FDIC staff also attends to discuss the FDIC's process for receivership. It is important for the PBS and EIC to understand the purpose of the capital call meeting and the effects on the bank. The EIC presents the results of the supervisory activity that resulted in the decision to hold the capital call meeting.

During the capital call meeting, the OCC informs the board that, because of losses identified during the supervisory activity or because of the bank's call report filing, the bank is or will soon become critically undercapitalized. When applicable, the OCC provides the board with a letter notifying the bank of its PCA capital category (known as a PCA letter). The PCA letter advises that limited time is available to adopt and implement a CRP to increase capital levels. If the bank is critically undercapitalized, the PCA letter reports the bank's tangible equity ratio and declares that under 12 USC 1831o, the OCC is required, within 90 days of the letter, to appoint a receiver or a conservator for the bank or take whatever action the OCC determines, with the FDIC's concurrence, would better achieve the purposes of PCA. Although banks are typically placed into receivership within 90 days, rare extensions are given when a capital injection is imminent. Banks may be closed sooner than 90 days when necessary.

The OCC may grant up to two 90-day extensions, provided that the FDIC concurs and the OCC documents why such extension would better serve the purposes of PCA. If the bank has been critically undercapitalized for 270 days, a receiver or conservator must be appointed unless the OCC and the FDIC make certain determinations and certify that the bank is viable and not expected to fail.[174]

After using the capital analysis worksheet to discuss capital needs in the capital call meeting, the EIC and PBS should request the board provide an update on capital raising efforts. The OCC reiterates to the board that receivership runs on a parallel path and that the OCC and FDIC welcome any viable and realistic plan to restore adequate capital or resolve the bank without a failure.

The FDIC representative attending the meeting describes the FDIC's process and requests the board's execution of an access resolution. The access resolution authorizes the FDIC to obtain bank information to market the bank and allows potential bidders to perform due diligence. For the failure to cause the least disruption possible, the FDIC needs access to bank information to assemble an information package for potential bidders.

[173] Refer to appendix D of this booklet for the capital analysis worksheet.

[174] Refer to 12 USC 1831o(h)(3).

Lastly, examiners should discuss the sensitivity of the information disclosed in the meeting and advise the board that rumors and speculation in the local community can cause a liquidity crisis; therefore, the board should plan for and monitor liquidity on an ongoing basis.

Bid Process

The bid process involves the FDIC's Division of Resolutions and Receiverships (DRR), with the OCC's approval, gathering information and marketing the failing bank's sale after determining the appropriate resolution structure. The DRR invites approved bidders to evaluate the potential acquisition in a virtual data room. After signing confidentiality agreements, bidders can review the informational bid package, including financial data on the bank, legal documents, and a description of available resolution methods. The DRR includes key dates, a description of the due diligence process, and the bidding procedures as part of the bid package. The transaction terms typically focus on the treatment of the deposits and assets held by the failing bank.

When necessary, the DRR schedules on-site due diligence by prospective bidders. The FDIC manages bidder due diligence to cause minimum disruption to the bank and to ensure confidentiality. OCC presence during the on-site due diligence normally is not required because a DRR representative is present. The prospective bidder is not allowed to ask bank management for assistance or clarification during on-site due diligence. Confidentiality is extremely important. All bidders must sign confidentiality agreements, including penalties for breaches.

The length of due diligence depends on the number of bidders and the target date of the receivership action. The bid process involves the DRR determining which bid is least costly to the DIF and working with the acquirer through the closing process. If there is no acquirer, the DRR ensures the payment of insured deposits. The closing date can be changed because of the circumstances or the submission of a realistic and viable recapitalization plan. The OCC and the FDIC do not share the potential closing date with the bank.

Examiner Responsibilities

During the 90 days before closing, examiners and the PBS

- coordinate with the FDIC as the DRR markets the bank and solicits bids.
- monitor the bank's condition.
- gather information to prepare the legal record.
- complete an electronic closing book that compiles the complete record of the legal and supervisory basis for the bank failure.
- respond to questions from OCC legal counsel, OCC licensing staff, OCC press relations staff, and the FDIC. Examiners must direct news media inquiries to OCC press relations staff.
- finalize the supervisory record, including any final ROEs.

Legal Review

OCC legal counsel uses the supervisory record to prepare required opinions, declarations, and decision documents in advance of closure. OCC legal counsel develops memorandums documenting the supervisory history and legal grounds for receivership. The Special Supervision Division, examiners, and OCC legal counsel document the grounds for the receivership and will hold a planning meeting when legal counsel begins drafting the memorandums. OCC legal counsel coordinates the legal review of a bank's failure, advises the PBS on closing-related legal issues, and prepares the closing documents. The PBS and OCC legal counsel should coordinate closely until the scheduled closing.

Reasons or grounds for closure and documentation for the grounds are included in required memorandums. The PBS and OCC legal counsel discuss the legal grounds that support the receivership and clarify the facts on which particular grounds depend. OCC legal counsel verifies that the grounds are accurate, the facts support the listed grounds, and there is sufficient documentation of facts for court review. There are typically several grounds listed in the OCC's documentation.

Assigned OCC attorneys work together to confirm the closing documents are consistent and that each document is legally and factually supportable. Closing documents are prepared in draft for review by the PBS, Director for Special Supervision, and Deputy Comptroller for Special Supervision. Once the closing documents are finalized, the Special Supervision Division and OCC legal counsel brief the appropriate senior deputy comptroller on the closing documents' contents in preparation for the bank closure.

OCC legal counsel compiles the official record of the decision to close the bank. This is the administrative record of the OCC's action and is used to defend the OCC's action if it is challenged in court. When appropriate, OCC legal counsel works with the Director for Special Supervision, the PBS, and the EIC to prepare legal defense. In such cases, OCC legal counsel coordinates its actions with the appropriate U.S. Attorney's Office.

The PBS and OCC legal counsel are responsible for preparing and distributing all documents required for the closing. The PBS maintains ongoing communication with the bank, the FDIC, and other OCC divisions involved in the closing. The PBS compiles the documents and other information related to the closing in an electronic closing book. Finally, the PBS generally serves as the on-site OCC closing manager on the day the bank is closed.

The OCC can stop the closing at any time up to the moment the appropriate senior deputy comptroller places the bank into receivership with the FDIC.

Closing Day Procedures

Banks typically are closed at the end of the business day on Friday, with an OCC or an FDIC representative in each branch office. If under new ownership, the bank normally reopens the next business day to provide customers with access to deposits.

Because of its significance, the closing is tightly structured. At the end of the business day for the bank and each branch office, the appropriate OCC senior deputy comptroller holds a teleconference with the EIC. The OCC's Deputy Comptroller for Special Supervision and Director for Special Supervision, OCC legal counsel, and an OCC press relations specialist also participate in the teleconference. The senior deputy comptroller asks the EIC a formal set of questions to verify the propriety of the decision to place the bank into receivership.[175] If the EIC's answers to the questions do not confirm the grounds for receivership, the OCC can halt the closing. If the answers demonstrate support for the legal grounds for receivership, the senior deputy comptroller appoints the FDIC as receiver for the bank.

Upon the senior deputy comptroller appointing the FDIC receiver, the OCC delivers closing papers to the bank and the FDIC to complete the transfer. As part of the closing process, the OCC recovers the original bank charter, if possible.

FDIC Resolution Methods

This section discusses the FDIC's two basic resolution methods: (1) deposit payoff, and (2) purchase and assumption (P&A) transactions.[176]

Deposit Payoff

A deposit payoff occurs when the OCC has appointed the FDIC as receiver and the FDIC does not receive any bids or the bids for a P&A transaction are not the least cost for the DIF. The three most common versions of a deposit payoff are the following:

- **Straight deposit payoff,** in which the FDIC determines which deposits are insured and mails a check to each insured depositor.
- **Insured deposit transfer,** in which the FDIC transfers the insured deposits to a transferee or agent to pay the customers the amount of their insured deposits or opens new accounts for customers at the agent institution.[177]
- **Deposit insurance national bank,** in which the FDIC creates a limited-life, limited-power bank with no capital to allow depositors to access their funds until they can transfer their banking relationships.

Depositors with uninsured funds and other general creditors of the failed banks do not receive immediate or full reimbursement. Instead, they must file a claim to receive a receivership certificate from the FDIC. A receivership certificate reflects the proved claim that the uninsured depositor or unsecured creditor has against the failed receivership and entitles its holder to a portion of the receiver's collections on the failed bank's assets. The

[175] Refer to appendix E of this booklet for a template of the closing questionnaire.

[176] For a complete description of the FDIC's resolution methods, refer to the FDIC *Resolutions Handbook*.

[177] An agent institution is the healthy institution that accepts the insured deposits and secured liabilities of a failed bank in an insured deposit transfer, in exchange for a transfer of cash from the FDIC. For more information, refer to the FDIC *Resolutions Handbook*.

percentage of claims eventually received depends on the value of the bank's assets, the number of uninsured claims, and each claimant's relative position in the distribution of claims.

Purchase and Assumption Transaction

A P&A transaction occurs when a healthy bank (referred to as the acquirer or the assuming bank) purchases some or all a failed bank's assets and assumes some or all the failed bank's liabilities, including insured deposits. As a part of the P&A transaction, the acquirer usually pays a premium to the FDIC for the assumed deposits, which decreases the FDIC's total resolution cost. Two of the most common P&A transaction types are:

- **Basic P&A:** The FDIC passes few assets to the acquirer.
- **Whole bank P&A:** The FDIC passes virtually all bank assets to the acquirer.

The FDIC attempts to reduce resolution costs by selling asset pools to banks that are not assuming deposits, selling a failed bank's branches to different banks, and entering loss-sharing agreements on certain asset pools.

Less common P&A transactions include:

- **Bridge bank P&A:** In exigent situations, the OCC may appoint the FDIC receiver before a final determination of the structure of the P&A or the identification of an acquirer. In these instances, the FDIC uses a bridge bank P&A to continue banking operations until the FDIC is ready to resolve the failed bank. A bridge bank is a special bank chartered by the OCC and controlled by the FDIC. The assets and liabilities of the bank in receivership are transferred into the bridge bank. The bridge bank operates like a normal bank in its interaction with customers and can operate for two years, with three one-year extensions. Then, when the FDIC is ready, it moves on to final resolution, either by selling or otherwise resolving the bridge bank.
- **P&A with optional shared loss:** Under loss share, the FDIC absorbs a portion of the loss on a specified pool of assets, which maximizes asset recoveries and minimizes FDIC losses. Loss share reduces the FDIC's immediate cash needs, is operationally simpler and more seamless to a failed bank's customers, and moves assets quickly into the private sector.[178]

Cross-Guarantees

Under 12 USC 1815(e), the FDIC may recoup losses to the DIF by assessing a claim against insured depository institutions under common control for losses caused by the failure of an affiliated insured depository institution (commonly referred to as the cross-guarantee authority). The cross-guarantee authority was granted to address problems encountered in the

[178] For more information on loss share transactions, visit the "Loss-Share Questions and Answers" page of the FDIC website.

resolution of certain large banks in the 1980s and effectively prevent banks from shifting assets and liabilities in anticipation of failure of one or more affiliated insured banks.

The cross-guarantee authority has limitations. The federal banking agencies are authorized to assess liability against any insured depository institution for losses incurred in connection with the default of a commonly controlled bank. Accordingly, if a bank is placed into receivership resulting in a loss to the DIF, the FDIC can cover that loss by making claims against affiliated banks—there is no ability to seek redress from the holding company for those losses. This insulation of holding companies and their nonbank affiliates from the cross-guarantee claims is important to consider in the resolution of multibank companies. For example, if a holding company pledge of assets is considered necessary in the approval of a CRP, examiners should consider requiring the pledge of non-bank-related assets. In so doing, shareholders of the holding company would stand to lose their investment in the failed banks, but also a substantial portion of any remaining value in the holding company.

Appendixes

Appendix A: Accounting Issues in Problem Banks

The following sections highlight accounting issues commonly identified in problem banks. The OCC's Office of the Chief Accountant can provide examiners with assistance in evaluating potential accounting issues, as appropriate. For more information on the topics discussed in this appendix, refer to the *Bank Accounting Advisory Series*, call report instructions, call report glossary, and other booklets of the *Comptroller's Handbook*.

Table 4 summarizes the applicable Accounting Standard Codification (ASC) guidance for various topics in this section.

Table 4: Summary of ASC guidance

Subject	Applicable accounting guidance
Reporting errors	ASC Topic 250
Fair value	ASC Topic 820
Debt securities and derivatives	ASC Topics 320 and 815
Loans and allowance	ASC Topics 310, 326, 340, and 450
Servicing rights	ASC Topic 860
Goodwill	ASC Subtopic 350-20
Deferred taxes	ASC Topic 740
Loan origination costs	ASC Topic 310
Troubled debt restructurings	ASC Subtopic 310-40
Loan sales	ASC Topic 860
Sale leaseback	ASC Topics 840 and 842
OREO	ASC Topics 310, 360, 606, and 610
Related-party transfers	ASC Topic 850

Call Report Errors

Regulatory reports must be complete and accurate, conform to U.S. GAAP, and comply with regulatory requirements.[179] GAAP defines an error in previously issued financial statements as, "An error in recognition, measurement, presentation, or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared." The OCC typically applies a similar definition to errors in regulatory reports (i.e., call reports).

[179] For example, regulatory reports are required to be provided to the OCC pursuant to 12 USC 161 (national banks) and 12 USC 1464(v) (FSAs).

Information about financial performance is especially important for a problem bank. Because of the sensitivity to a problem bank's financial condition, management may be slow to recognize losses or may omit or obscure poor financial results and disclosures that may indicate increased risk and a deteriorating financial condition. For example, some banks do not appropriately disclose significant gains and losses, pending litigation, allowance levels, charge-offs, and other financial information. If this information is not disclosed and dealt with in a timely manner, problems may worsen and ultimately impair the bank's earnings, liquidity, and capital.

Ongoing reviews of quarterly financial results, reviews of audit conclusions and work papers, and the verifications of financial reports, such as the call report, are key to identifying potential errors. If examiners identify material errors in the bank's call report(s), the OCC may require a bank to amend its call reports containing the errors. If errors are not material, examiners should not require the bank to file amended call reports. The determination of materiality is based on the specific circumstances.

Examiners should use both a quantitative and qualitative approach to determine if an error is material. A quantitative analysis normally includes comparing the amount of the error (or errors) to the relevant amounts in the balance sheet and income statement (Schedules RC and RI) as well as supplemental schedules in the call report, such as the regulatory capital schedule (Schedule RC-R). A qualitative analysis is an assessment of the facts, circumstances, nature, and cause of the error (or errors). The qualitative assessment can be important, as even a small quantitative misstatement may be material if, for example, it affects compliance with regulatory requirements, changes a loss into income, affects management compensation, or hides an unlawful transaction.

Bank Asset Accounting and Valuations

Accounting for many assets and liabilities involves the use of management judgment. When management applies judgment, there are opportunities to incorporate assumptions that improve earnings or capital positions. A problem bank may adopt overly aggressive accounting estimates, value assets improperly, or enter into unusual or related-party transactions to reduce losses or improve earnings. Potential accounting topics that involve judgment are described in the following sections.

Fair Value Measurement

The measurement of various assets and liabilities, including trading assets and liabilities, available-for-sale securities, loans held for sale, assets and liabilities accounted for under the fair value option, and foreclosed assets, involves the use of fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction[180] between market participants at the measurement date (also referred to as an exit price). The exit price should be based on the price that would be received in the bank's

[180] An orderly transaction is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced liquidation or distressed sale.

principal market for selling that asset. The principal market is the market the bank has historically sold into with the greatest volume. If the bank does not have a principal market for selling that asset, the exit price should assume the asset is sold into the most advantageous market.

ASC Topic 820, "Fair Value Measurement," establishes a three-level fair value hierarchy that prioritizes inputs used to measure fair value based on observability. The highest priority is given to level 1 (observable, unadjusted inputs) and the lowest priority to level 3 (unobservable inputs). The broad principles for the hierarchy are as follows:

- **Level 1** fair value measurement inputs are the most reliable and are based on quoted prices (unadjusted) for identical assets or liabilities in an active market.
- **Level 2** fair value measurement inputs are market-based inputs other than quoted prices included within Level 1 that are directly or indirectly observable.
- **Level 3** fair value measurement inputs are unobservable inputs for the asset or liability that are not corroborated by observable market data.

When dealing with inactive markets or transactions that are not orderly, fair value measurements should be determined consistent with the objective of fair value set forth in ASC Topic 820, even though considerable judgment may be required.[181]

Debt Securities

Accounting for debt securities is based on management's intent at acquisition of the security. If management has the positive intent and ability to hold the security until maturity, then the asset is designated as held-to-maturity (HTM). If the bank purchases a security and management intends to sell the security in the near term, the security is designated as trading. All other securities are designated as available-for-sale (AFS).

Trading securities are reported at fair value with unrealized gains and losses recognized in current income. AFS securities are recorded at fair value with unrealized gains and losses reported in other comprehensive income. HTM securities are recorded at amortized cost.

At each reporting date, the appropriateness of the classification of securities should be reassessed. For HTM securities, the focus of this re-assessment is on the entity's ability to hold a security until maturity. Transfers from the HTM category and trading category should be rare, so a sale or transfer calls into question (or "taints") the management's intent about holding all securities that remain in the HTM classification.

There are circumstances, however, when the change in the intent to hold a certain security to maturity would not taint the intent to hold other debt securities to maturity. Examples of these circumstances include evidence of significant deterioration in an issuer's creditworthiness or a business combination or disposition. In order not to taint the intent to

[181] For more information, refer to the "Fair Value" entry of the call report instructions glossary.

hold other securities into the future, the event must be isolated, nonrecurring, unusual for the bank, and not reasonably anticipated.[182]

Derivatives

A derivative instrument is a financial instrument or contract where the value of the instrument is based on an underlying variable (e.g., a security or index) and has stated terms to determine the amount and form of settlement. These instruments are recorded at fair value with unrealized gains and losses recognized in current income.[183]

Other Real Estate Owned

Financial difficulties of borrowers can result in foreclosure or repossession of collateral, with the bank becoming an owner and subsequent seller of the collateral. Upon foreclosure or physical possession, whichever is earlier, OREO should be recorded at the fair value of the property, less the estimated cost to sell. This amount becomes the new cost basis of the property. The amount by which the recorded investment[184] in the loan exceeds the new cost basis is a loss and must be charged off through the allowance at the time of foreclosure or repossession.

Subsequent to transfer, OREO must be carried at the lower of cost or fair value, less estimated costs to sell. Subsequent declines in the fair value of OREO below the new cost basis are recorded through the use of a valuation allowance.[185]

A valuation allowance allocated to one property may not be used to offset losses incurred on another property. Unallocated OREO valuation allowances are not acceptable. Subsequent increases in the fair value of a property may be used to reduce the allowance but not below zero.

For more information about OREO accounting, refer to the "Other Real Estate Owned" booklet of the *Comptroller's Handbook*.

[182] Refer to the *Bank Accounting Advisory Series*, Topic 1, "Investment Securities."

[183] Refer to ASC Topic 815, "Derivatives and Hedging," as well as the *Bank Accounting Advisory Series*, Topic 11B, "Hedging Activities."

[184] The recorded investment in the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

[185] A bank may also reduce an OREO property's value via direct write-off rather than establishing a valuation allowance. When a bank reduces a property's value by direct write-off, a new cost basis for the property is established. Subsequent to the direct write-off, the bank may establish a valuation allowance for any additional fair value decline rather than record an additional direct write-off. For more information, refer to the *Bank Accounting Advisory Series*, Topic 5A.

Lender-Paid Insurance on Foreclosed Real Estate

Banks may acquire mortgage insurance on originated loans to reduce the amount of losses experienced if the borrower defaults. Upon foreclosure, management should evaluate the probability that the insurer will pay the associated insurance claim by assessing the insurer's creditworthiness, likelihood of litigation claims, and history of paying insurance claims. If management determines that it is probable that the insurer will pay and receipt of the claim is reasonably assured, management should recognize a receivable in the balance sheet.

Servicing Assets

Mortgage servicing assets (MSA), also referred to as mortgage servicing rights (MSR), are intangible assets that banks may purchase, assume, or retain in a sale of mortgage loans. A bank must recognize and initially measure a servicing asset or servicing liability at fair value each time it undertakes an obligation to service a financial asset. This occurs when

- a bank sells its financial assets in a transfer that meets the requirements for sale accounting and remains the servicer for the transferred assets; or
- a bank acquires or assumes a servicing obligation that does not relate to its financial assets or those of its consolidated affiliates.

A servicing asset or servicing liability is initially measured at fair value regardless of whether explicit consideration is exchanged. A bank that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting under ASC Topic 860 is accounted for as a secured borrowing with the underlying assets remaining on the bank's balance sheet. The bank must not recognize a servicing asset or a servicing liability.

After initially measuring a servicing asset or servicing liability at fair value, a bank should subsequently measure each class of servicing assets and servicing liabilities using one of the following methods:

- **Amortization method:** Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income (when servicing revenues exceed servicing costs) or net servicing loss (when servicing costs exceed servicing revenues), and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date.
- **Fair value measurement method:** Measure servicing assets or servicing liabilities at fair value at each reporting date, and report changes in fair value of servicing assets and servicing liabilities in earnings in the period in which the changes occur.

Regardless of how a bank acquires an MSA, a bank that elects the amortization method to account for its MSAs must amortize the MSAs in proportion to and over the period of estimated net servicing income. A straight-line approach may not be appropriate if it does not approximate the rate at which a bank realizes net servicing income from the MSAs.

If accounted for at amortized cost, banks should evaluate and recognize temporary impairment through a valuation allowance when the net carrying amount of the MSA exceeds its fair value. If the fair value of the MSA increases after recognition of temporary impairment, banks may increase the carrying amount of the MSA (through a reduction of the valuation allowance) but not above its amortized cost basis. If impairment is determined to be other-than-temporary, a direct write-down of the carrying amount of the MSA should be taken.[186]

Goodwill

Goodwill is accounted for under ASC Topic 350-20, "Intangibles – Goodwill and Other, Goodwill." GAAP does not permit public business entities to amortize goodwill. Instead, goodwill is evaluated for impairment at the reporting unit (or operating segment) level on an annual basis. More frequent evaluations are required if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Impairment exists when the carrying amount of a reporting unit, including goodwill, exceeds its fair value.

A goodwill impairment loss is recognized for the amount that the carrying amount of a reporting unit, including goodwill, exceeds its fair value. After an impairment loss is recognized on a reporting unit's goodwill, the adjusted carrying amount of that goodwill becomes its new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss has been recorded.

When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit must be included in the carrying amount of the reporting unit when determining the gain or loss on disposal. When a portion of a reporting unit that constitutes a business is to be disposed of, goodwill associated with that business must be included in the carrying amount of the business in determining the gain or loss on disposal. Otherwise, an institution may not remove goodwill from its balance sheet, for example, by attempting to sell or dividend this asset to its parent holding company or another affiliate.

A private company may elect to amortize goodwill on a straight-line basis over a useful life of 10 years (or less if appropriate) and perform a single-step impairment test at either the entity level or the reporting unit level. If a private company makes this election, the private company is required to make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level. Goodwill must be tested for impairment when a triggering event occurs that indicates that the fair value of an entity or a reporting unit, as appropriate under the private company's accounting policy election, may be below its carrying amount.[187]

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[186] For more information about accounting for MSAs, refer to the *Bank Accounting Advisory Series,* Topic 9A, "Transfers of Financial Assets and Servicing"; the "Mortgage Banking" booklet of the *Comptroller's Handbook*; and the "Servicing Assets and Liabilities" entry of the call report instructions glossary.

[187] Refer to the *Bank Accounting Advisory Series,* Topic 10b, "Intangible Assets," and the "Goodwill" entry in the call report instructions glossary.

Deferred Taxes

Some problem banks have sought to maximize their income and capital by recording deferred tax assets (DTA) for the estimated future tax effects that arise from deductible temporary differences (future reductions in taxable income) and net operating loss carryforwards. A difference between the tax basis of an asset or a liability and its reported (or book) amount will result in taxable or deductible amounts in future years when the reported amounts of assets are recovered and then settled. ASC Topic 740, "Income Taxes," allows the recognition of those future tax benefits by recording DTAs. The future realization of DTAs depends on the existence of sufficient taxable income of the appropriate character (e.g., ordinary income or capital gain). The following four possible sources of taxable income may be available to realize the DTAs:

- Future reversals of existing temporary differences.
- Future taxable income exclusive of reversing temporary differences and carryforwards.[188]
- Taxable income in carryback years if permitted under tax law.[189]
- Tax planning strategies.

GAAP requires a bank to reduce the measurement of DTAs not expected to be realized by recording a valuation allowance. To determine whether a valuation allowance is needed, both positive and negative evidence is considered. The weight given to the potential effect of negative and positive evidence shall be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, the more positive evidence is necessary to support a conclusion that a valuation allowance is not needed. Generally, the ability to realize a DTA is more questionable for a bank that has experienced cumulative losses in recent years, is projected to have losses in upcoming years, or is experiencing unsettled circumstances that could adversely affect future profit levels.

GAAP limits the net amount of DTAs that may be recognized based on a "more likely than not" realization criteria. Regulatory capital rules may further limit DTAs. For purposes of regulatory capital, any valuation allowances are netted against DTAs before the application of any regulatory capital limitations.

Call report instructions state that a bank generally should account for income taxes as if the bank were a separate entity. As such, the payment or transfer of deferred tax assets or deferred tax liabilities by the bank to another member of the consolidated group is generally prohibited. Such a transaction lacks economic substance, because the parent legally cannot

[188] The Coronavirus Aid, Relief, and Economic Security (CARES) Act amends the Tax Cuts and Jobs Act of 2017 by removing the 80 percent taxable income limitation for NOL deductions that are utilized in tax years beginning before January 1, 2021 (i.e., carryforwards generated prior to a bank's 2021 tax year can be carried forward indefinitely and can offset 100 percent of taxable income). An NOL carryforward generated in 2021 and later is carried forward indefinitely but can only offset 80 percent of taxable income.

[189] The CARES Act amends the Tax Cuts and Jobs Act of 2017 to allow for the carryback of losses arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, to each of the five taxable years preceding the table year of the loss. For calendar year taxpayers, net operating losses incurred in tax years ending December 31, 2018, 2019, and 2020 are eligible for a five-year carryback.

relieve the subsidiary of a potential future obligation to the taxing authorities. There is an exception to this general rule for certain net operating loss (NOL) carryforwards that are utilized. If the bank would not have been able to use the NOL carryforwards on a standalone basis but the parent in a consolidated tax filing group can use the bank's NOL carryforwards in the current period, the bank may transfer its NOL carryforward to the parent in exchange for cash.[190]

Problem Asset Management

The following topics cover specific components of problem asset management that relate to accounting.

Loan Origination Costs

GAAP allows only certain direct loan origination costs for completed loans to be deferred for income statement recognition. The deferred amounts are offset against loan fees and the net loan fee or net loan cost amount is amortized to earnings over the life of the related loan. Overhead costs, such as advertising, soliciting, and administrative costs should not be deferred. Rather, they should be charged to expense in the period incurred. Banks are not permitted to increase income and capital by capitalizing loan origination costs in excess of the amount allowed under GAAP. Significant costs that do not qualify for deferral may result in reporting errors and restatement of regulatory reports.[191]

Nonaccrual

Loans that are nonperforming should be evaluated for placement on nonaccrual status. Appropriate management of nonperforming assets is critical in rehabilitating problem banks. Compliance with nonaccrual requirements is important to ensure that income accrued on loan receivables is not overstated. An overstatement of accrued interest can affect earnings and capital and result in misstatement of the bank's financial condition. Interest income generally is not recognized during the period a loan is on nonaccrual status.

Banks must place loans on nonaccrual status when full repayment of interest and principal is not expected, or when loans become 90 days or more delinquent and are not both well secured and in the process of collection. Previously accrued and unpaid interest generally should be reversed out of interest income.

In determining when a loan is in the process of collection, payment is generally expected within the next 30 days. A longer period may be acceptable if the timing and amount of repayment is reasonably certain. Because of the uncertain collectability of loans on nonaccrual, interest payments received are applied against the loan's carrying amount.

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[190] Refer to the *Bank Accounting Advisory Series*, Topic 7A, Deferred Taxes," and Topic 7B, "Tax Sharing Arrangements"; and the "Income Taxes" entry of the call report instructions glossary.

[191] Refer to ASC 310-20, "Receivables – Nonrefundable Fees and Other Costs," and the *Bank Accounting Advisory Series,* Topic 2D, "Origination Fees and Costs."

Interest income may, however, be recognized on a cash basis when recovery of the recorded loan balance is reasonably assured.

There are certain exceptions to the general nonaccrual rules. Most notably, consumer loans are not subject to the general nonaccrual rules. Such loans should be subject to other alternative methods of evaluation to assure that the bank's net income is not materially overstated. The other major exception is for purchased credit-impaired (PCI) loans.

If a bank has adopted ASC Topic 326 and has purchased financial assets with credit deterioration that would otherwise be in nonaccrual status, the bank may elect to continue accruing income if certain conditions are met. The conditions provide that bank management should be able to (1) reasonably estimate the amounts of cash flows expected to be collected, and (2) support that the asset was not acquired primarily for the rewards of ownership of the underlying collateral. The asset should be subject to other alternative methods of evaluation to assure the bank's net income is not materially overstated.

Banks must determine which loans must be placed on nonaccrual and record necessary reversals of interest earned but not collected. To meet this requirement, banks typically conduct a quarterly analysis of loan portfolios. In addition, an assessment should be performed as to whether the recorded loan balance is fully collectible for those loans for which interest income is recognized on a cash basis.[192]

Troubled Debt Restructurings

Accounting for loan modifications executed to address nonperforming loans should include an assessment of whether the modified loan qualifies as a troubled debt restructuring (TDR). A bank may work with borrowers experiencing financial difficulties to restructure their loans to reduce nonperforming assets and maximize collections. Workout strategies generally involve a modification of terms and are made to improve a loan's collectability. Accounting and disclosure of TDRs is necessary when the loan modification is executed for a borrower experiencing financial difficulty and a concession is granted to the borrower.

A problem bank may have a significant volume of loan modifications due to deficient credit risk management practices. The level of reported TDRs and related allowance may indicate the extent to which the bank has addressed its problem loans. Collectability of future payments in a restructuring is sometimes questionable, however, particularly if modified terms offered to the borrower are not commensurate with the borrower's ability to repay. A credit evaluation should be performed when modifying loan terms to determine if the allowance attributable to these loans is appropriate and if any additional charge-offs are warranted.

If a concessionary interest rate or principal reduction is granted because of the borrower's financial difficulties, and the restructuring is designated as a TDR, the allowance should be measured based on (1) the present value of the expected future cash flows, discounted at the

[192] Refer to the *Bank Accounting Advisory Series,* Topic 2B, "Nonaccrual Loans," and the "Nonaccrual Status" entry in the call report instructions glossary.

effective interest rate in the original loan agreement, (2) the loan's observable market price, or (3) the fair value of the collateral, if collateral dependent. If foreclosure is probable, the use of the fair value of collateral for allowance measurement is required. For those institutions that have adopted ASC Topic 326, any measurement method allowed under the current expected credit losses model may be used to measure the allowance for TDRs. If the concession can only be measured using a discounted cash flow approach, however, the bank must use the present value of expected future cash flows.

The restructuring of a loan by itself generally does not warrant immediately returning a loan to accrual status. When a loan is restructured, the borrower must demonstrate the ability to comply with the new loan terms. A period of payment performance (generally a minimum of six months) is required before returning the loan to accrual status. If the borrower had been making payments (for at least six months) equal to those required by the restructured loan agreement, however, immediate return to accrual status may be appropriate.[193]

Loan Losses

A problem bank's earnings and capital are directly affected by the level of provisions for credit losses that are recognized in the reporting period. Timely loss recognition through provision expense remains critical to assessing the bank's current financial condition. In addition, due to the elevated level of problem assets commonly found in problem banks, charge-off practices to remove loans that are no longer bankable assets are paramount.

Problem banks may attempt to improperly delay the actual charge-off of credit losses. GAAP requires that identified losses be charged off against the allowance in the period that they become uncollectible. Delaying recognition of losses into another reporting period misstates the bank's allowance, regulatory capital, and historical loss experience. The bank's overall allowance is included in tier 2 capital subject to certain limitations. Large loan and other asset write-downs occurring shortly after the end of the year or the end of a quarter should be monitored closely. If evidence of loss was or should have been available before the end of a reporting period, the bank must report the charge-off in that previous period.

Loan Sales

Many problem banks sell nonperforming assets to improve the bank's nonperforming asset levels. A bank's ability to sell the assets depends on the level of deterioration of the assets, current market conditions, and the number of willing buyers in the marketplace at the time of the offering. The benefits to the bank when selling nonperforming assets include reduction in credit exposure and required credit loss allowance, improvement of nonperforming asset ratios, and increased earnings and capital after the sale.

[193] Refer to the *Bank Accounting Advisory Series*, Topic 2A, "Troubled Debt Restructurings," and Topic 12B, "Troubled Debt Restructurings." Refer also to the "Troubled Debt Restructurings" entry in the call report instructions glossary.

The ability to recognize a sale of loans and therefore derecognize the loans from the bank's balance sheet depends on whether the conditions for sales accounting treatment are met. To qualify for sales treatment, the following conditions must be satisfied under GAAP:[194]

- Transferred assets are legally isolated from the bank.
- Transferee has the ability to pledge or exchange the transferred assets.
- The bank does not retain effective control over the transferred assets.

When a transfer of financial assets meets the conditions for sales accounting treatment, a bank should derecognize all the assets sold and recognize any assets obtained and liabilities assumed in the sale at their respective fair values. Retained assets, such as a servicing asset, and any liabilities assumed are considered part of the proceeds received. The difference between the proceeds received and the amount derecognized is the gain or loss on the sales transaction.

Sale-Leaseback Transactions

Problem banks might also enter into sale-leaseback transactions on bank-owned property to recognize gains and increase capital. Generally, any resulting gain applicable to the bank's leaseback must be deferred. The lease term in such transactions may be unusually short and often does not represent the intent of the parties involved in the transaction. Terms on these transactions can significantly increase the amount of income that can be recognized, but do not reflect the intended use of the property. Typically, the lease term is expected to be close to the remaining useful life of the asset leased.[195]

For banks that have adopted Accounting Standards Update (ASU) 2016-02, "Leases (Topic 842)," the bank may recognize the entire gain as of the sale date if the transaction meets the criteria for sales accounting treatment.[196]

Other Real Estate Owned Sales

Problem banks may focus efforts to reduce nonperforming assets through sales of OREO. Similar to loan sales, derecognition of OREO properties will improve nonperforming asset ratios and reduce expenses associated with maintaining the property. The ability to recognize a sale of OREO and therefore derecognize the property from the problem bank's balance sheet depends on whether the conditions for sales treatment under GAAP are met.

Examples of inappropriate actions by banks and application of ASC Subtopic 360-20 requirements include

[194] Refer to ASC Topic 860-20, "Transfers and Servicing – Sales of Financial Assets."

[195] Refer to the *Bank Accounting Advisory Series,* Topic 3C, "Sale-Leaseback Transactions."

[196] ASC Topic 842 will be effective for nonpublic business entities for annual periods beginning after December 15, 2021, and interim and annual periods within fiscal years beginning after December 15, 2022. Early adopted is permitted.

- indirectly providing the borrower with funds for the required down payment by issuing a working capital loan or allowing draws on an unrelated line of credit with the bank.
- recognizing income on the sale in the absence of an adequate down payment amount.
- providing a loan to the borrower at below-market interest rates to facilitate the OREO sale.

For more information about OREO accounting, refer to the "Other Real Estate Owned" booklet of the *Comptroller's Handbook*.

Related Party Transfers

The transfer of assets to related parties such as a holding company or other bank affiliate is a practice commonly used by problem banks to remove low-quality assets from the bank's balance sheet. These transfers are frequently executed at prices that do not represent a value that would be exchanged in an arms-length transaction. Typically, transfers are designed to recognize gains or avoid losses that affect the problem bank's earnings and capital.

Transfers of bank premises or other assets to affiliated parties in exchange for promissory notes may not reflect the true economic results of the transaction, and the likelihood of full repayment is uncertain. Assets exchanged for limited partnership interests solely to purchase the bank's properties are similarly of concern. Such transfers should be executed at a sales price that does not exceed market values, especially if the affiliated parties are heavily indebted to the bank.[197]

Reclassification to Held for Sale

Another strategy intended to reduce the level of reported nonperforming assets or reported loan losses can include reclassifying loans as held for sale (HFS). Use of the HFS account may be appropriate in certain circumstances. The inappropriate transfer of loans to HFS can reduce or mask the reported level of problem assets. The transfer also prospectively reduces charges to the credit loss allowance. If a loan is maintained on nonaccrual before, or subsequent to, being transferred to the HFS account, the loan should continue to be included with other nonaccrual loans for regulatory reporting.

At the time a decision is made to sell loans, the loans should be clearly identified and transferred to an HFS account. The transfer to the HFS account must be made at the lower of cost or fair value in the period in which the decision to sell is made. Any reduction to reflect the loans' lower fair value that is primarily attributed to credit factors should be recorded as a charge-off against the allowance. Declines in fair value due to interest rate fluctuations or changes in foreign exchange rates are generally recorded through other noninterest expense. When a decline in value results from both credit and market factors, the primary factor

[197] Refer to ASC Topic 850, "Related Party Disclosures," and the *Bank Accounting Advisory Series,* Topic 10E, "Related Party Transactions (Other Than Reorganizations)."

should be determined and accounting should be based on this determination. In many cases, the decline in value of commercial loans is generally due to credit factors.[198]

[198] Refer to ASC 310-10, "Receivables – Overall," ASC 326-20, "Financial Instruments – Credit Losses - Measured at Amortized Cost," and the *Bank Accounting Advisory Series,* Topic 2E, "Loans Held For Sale."

Appendix B: Problems in Large Banks or Federal Branches and Agencies

The rehabilitation or resolution of large and multibank companies presents unique challenges. In addition to the risks discussed earlier in this booklet, it is important for examiners to assess the holding company's ability to support bank operations, the condition of commonly controlled depository institutions, and the potential systemic risk posed by the bank's failure.

While problem identification and resolution for the largest banks have unique requirements, large banks are subject to the same statutes and regulations as all insured OCC-supervised banks. In the problem bank context, this means that large banks are subject to the capital, liquidity, and accounting requirements that apply to all insured banks. Timely identification and communication of problems are critical to the successful rehabilitation of large problem banks.

In assessing options for the resolution of large banks, it is useful to consider the changes to the supervisory landscape due to prior financial crises. Several fundamental regulatory and supervisory changes occurred in these periods. For large and multinational banks, additional changes occurred. Industry consolidation created several extremely large, diversified financial institutions. Their size and breadth affect the systemic risk analysis associated with large problem companies. To address problems that arise with very large financial institutions, the U.S. introduced resolution plan requirements for the largest global systemically important financial institutions (G-SIFI) or global systemically important banks (G-SIB) in the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010.[199] The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 raised the asset threshold in Dodd–Frank from $50 billion to $250 billion. The FDIC requires a separate resolution plan, called a covered insured depository institution (CIDI) resolution plan, for certain large, insured depository institutions.[200]

Severe stress events at large, complex banks can have a destabilizing effect on the U.S. economy, capital markets, and the overall financial stability of the federal banking system. Large banks face additional challenges because of their complex organizational structures, shared service models, technology frameworks, and wide geographic operations. Examiners should be familiar with the recovery plan guidelines in 12 CFR 30, appendix E, that apply to banks with assets over $250 billion. Large-scale stress events highlight the need for large, complex banks to plan how they will respond. For more information, refer to the "Recovery Planning" booklet of the *Comptroller's Handbook*.

The resolution of large banks involves balancing an assessment of systemic risk with the application of and emphasis on market discipline. Within this context, the proper exercise of

[199] Refer to 12 USC 5365, "Enhanced Supervision and Prudential Standards for Nonbank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies."

[200] Refer to 12 CFR 360.10, "Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets."

supervisory discretion remains a critically important aspect of the resolution of large problem companies.

Liquidity Considerations

The fundamentals of identifying, measuring, monitoring, and controlling liquidity risk at large and multibank companies are the same as described in the "Liquidity" section of this booklet. The scope and scale of potential liquidity problems at large and geographically dispersed banking companies present unique challenges to examiners. Moreover, the international nature of certain business and funding activities of these companies necessitates more intricate coordination and an understanding of the requirements of multiple legal and political jurisdictions. Examiners should understand the bank's operating structure and legal entities, which may involve extensive coordination with other regulators.

The large scale of some bank operations can increase the difficulty of determining the extent of liquidity problems, the effects of such problems on the bank's condition, and public perception. Banks operating in other countries generally do so under prevailing local laws and customs. Examiners should consider the complexity of banks' operating conditions, including the interrelationship of legal entities, when reviewing liquidity.

Systemic Risk

The large bank's closure could significantly affect the banking industry and have destabilizing repercussions on the overall economy. FDICIA fundamentally altered this systemic risk determination in three ways.

First, FDICIA required bank regulators to choose the "least-cost" alternative in resolving failing banks. An exception to this provision applies to banks whose failure would cause "serious adverse effects on economic conditions and financial stability." Second, FDICIA significantly limited Federal Reserve discount window advances to troubled banks. This restriction affects the ability of regulators to manage the failure resolution process. Third, FDICIA introduced PCA for insured depository institutions. The OCC is required under PCA to appoint a receiver or conservator when such an institution has been critically undercapitalized for 90 days. The OCC may grant up to two 90-day extensions, provided that the OCC and the FDIC concur and document why such extensions would better serve the purpose of PCA. If the bank has been critically undercapitalized for 270 days, a receiver or conservator must be appointed unless the OCC and the FDIC certify that the bank is viable and not expected to fail.

Today's large banking organizations are larger and more diversified and complex than their predecessors, making it more likely that the failure of a large bank would be destabilizing. Therefore, in the systemic risk analysis of these banking organizations, examiners generally determine

- the bank's relevant market shares by geography and product.
- the number and nature of relationships with correspondent and serviced institutions.

- potential effects on domestic and international counterparties.
- potential effects on payment systems.

Problems in Federal Branches and Agencies

Federal branches and agencies of foreign banking organizations (FBO) are exposed to the same risks as domestic commercial banks. Nonetheless, they are not stand-alone entities in their corporate structures, and certain aspects of their risk profile are affected by the financial condition of the FBO head office. Moreover, consideration of an FBO's home country's economic, political, and financial environment, including coordination with home country banking supervisors, is an important element of effective supervision of an FBO's U.S. operation.

The FBO's financial condition can affect federal branches and agencies in several ways, such as

- an unanticipated withdrawal of third-party funding.
- the inability to obtain dollars from the FBO to fund cash outflows.
- deterioration in asset quality if loans extended by the federal branch or agency are concentrated in the home country where economic problems are worsening.

Supervisory and Enforcement Actions in Federal Branches and Agencies

The wide range of supervisory and enforcement actions addressing deficiencies in national banks and federal savings associations can usually be used to address concerns about the operations of federal branches and agencies. The OCC's supervisory and enforcement actions are taken after an evaluation of case-specific facts and circumstances. The type of action depends on the nature, extent, and seriousness of the deficiencies or problems, the branch's or agency's condition and supervisory history, and the ability and cooperation of local and head office management. Generally, a composite ROCA rating of 3 or worse prompts consideration of an enforcement action. The OCC may also take enforcement actions, including civil money penalties, against institution-affiliated parties of federal branches or agencies if legally supportable and warranted. In certain circumstances, the OCC, on its initiative or at the Federal Reserve's recommendation, may terminate a federal branch or agency's license.[201] The OCC may also take supervisory actions when questions arise about the FBO's ability to support its federal branches or agencies or when the FBO's home country is in significant economic turmoil.[202] When liquidity, transfer,[203] or credit risk are supervisory concerns, certain requirements can be included in enforcement actions that are

[201] Refer to 12 USC 3102(i), "Termination of Authority to Operate Federal Branch or Agency," and 3105(e)(5), "Recommendation to Agency for Termination of a Federal Branch or Agency."

[202] Refer to 12 USC 3102(g) and 12 CFR 28.20(a).

[203] Transfer risk is the risk that an asset cannot be serviced in the currency of payment because of a lack of, or restraints on the availability of, foreign exchange in the obligor's country.

unique to federal branches and agencies. These unique actions reflect the wholesale funding and absence of a separate and distinct capital base in federal branches and agencies.

For more information, refer to the "Supervisory and Enforcement Actions" section of the "Federal Branches and Agencies Supervision" booklet of the *Comptroller's Handbook*.

Appendix C: Sample Capital Restoration Plan Guarantee

The sample guarantee

- references the parties to the guarantee (the bank and the guarantor holding company(s)).
- incorporates by reference the CRP submitted for approval by the bank.
- provides that the holding company unconditionally guarantees and provides a financial commitment that the bank will comply with its CRP.
- provides that the holding company will
  - take any action directly required under the CRP.
  - take any corporate actions necessary to enable the bank to take actions required of the bank under the CRP.
  - not take any action that would impede the bank's ability to implement its CRP.
  - ensure that the bank is staffed by competent management.
  - restrict transactions between the holding company and the bank.
- states the limit of liability and the promise to pay the amount described.
- incorporates by reference a certified resolution of the board of the holding company regarding the guarantee.
- describes the consideration provided and certain rights of the parties.
- provides for the pledge of holding company assets, or other appropriate collateral, to secure the guarantee, when deemed appropriate.
- includes certain other provisions, such as a statement on governing law.

The guarantee is patterned after a standard commercial guarantee. It requires the controlling company to perform on its guarantee when the bank notifies the company that the bank has failed to comply with its CRP. If the bank declines or delays in enforcing the guarantee, the OCC may direct the bank to enforce the guarantee or take any other action under PCA or 12 USC 1818 as appropriate. If the bank is placed in receivership, the FDIC as receiver is entitled to the proceeds of any contribution by the company.

Capital Restoration Plan Guaranty Agreement

[For national banks] This Agreement is made this _____ day of _____, 20__, by and between [INSERT NATIONAL BANK NAME, CITY, STATE], a national banking association chartered and examined by the Office of the Comptroller of the Currency ("OCC") pursuant to the National Bank Act of 1864, as amended, 12 U.S.C. § 1 et seq., ("Bank") and [INSERT HOLDING COMPANY NAME], a "controlling company" that controls the Bank for purposes of 12 U.S.C. § 1831o and 12 C.F.R. Part 6 ("Guarantor").

[For federal savings associations] This Agreement is made this _____ day of _____, 20__, by and between [INSERT FEDERAL SAVINGS ASSOCIATION NAME, CITY, STATE], a federal savings association chartered and examined by the Office of the Comptroller of the Currency ("OCC") pursuant to the Home Owners' Loan Act of 1933, as amended, 12 U.S.C. § 1461 et seq., ("Bank") and [INSERT HOLDING COMPANY

NAME], a "controlling company" that controls the Bank for purposes of 12 U.S.C. § 1831o and 12 C.F.R. Part 6 ("Guarantor").

WHEREAS, the Bank is [undercapitalized, significantly undercapitalized, critically undercapitalized] pursuant to 12 U.S.C. § 1831o and 12 C.F.R. Part 6. The Bank was notified, or was deemed to have notice, in accordance with 12 C.F.R. 6.3, that it is [undercapitalized, significantly undercapitalized, critically undercapitalized] on [Date];

WHEREAS, the Bank has submitted a capital restoration plan ("CRP") in accordance with 12 U.S.C. § 1831o(e). The CRP is attached as Exhibit A and incorporated herein by reference;

WHEREAS, the Bank desires to obtain the Guarantor's guaranty that the Bank will comply with the CRP to obtain approval of the CRP from the OCC;

WHEREAS, the Guarantor desires to guarantee the Bank's performance of the CRP and to provide assurances of performance; and

WHEREAS, the Guarantor represents that it owns and controls ___% of the stock of the Bank and expects to derive advantage from its guaranty by enhancing the financial strength of the Guarantor and the value to its shareholders by enhancing the financial strength of its asset, the Bank.

NOW THEREFORE, in consideration of the representations set forth above, the parties agree as follows:

1. Guaranty. The Guarantor(s) [jointly and severally] unconditionally guarantee(s) that the Bank will comply with the CRP until the OCC notifies the Bank, in writing, that the Bank has been "adequately capitalized", in accordance with 12 C.F.R. 6.4, on average for four consecutive quarters.

2. Additional Undertakings by Guarantor. The Guarantor shall use its best efforts to: (a) take any actions directly required of the controlling company under the CRP; (b) take any corporate actions necessary to enable the Bank to take actions required of the Bank under the CRP; (c) not take any action that would impede the Bank's ability to implement its CRP; (d) ensure that the Bank has competent management; and (e) restrict transactions between the Guarantor and the Bank as provided in 12 C.F.R. Part 6.

3. Performance of Guaranty. Upon receipt of written notice from the OCC that the Bank has failed to comply with the CRP, the Bank shall notify the Guarantor in writing of its failure to comply with the CRP and the Guarantor shall pay to the Bank, or its successors or assigns, the amount indicated in the Bank's notice as necessary to bring the Bank into compliance with the CRP. The amount indicated in the Bank's notice to the Guarantor shall be the amount indicated in the OCC's notice to the Bank. Notwithstanding the foregoing, the Guarantor's total liability under this Agreement shall not exceed 5 percent of the Bank's total assets at the time the Bank was notified, in accordance with 12 C.F.R. 6.3, that the Bank was

[undercapitalized, significantly undercapitalized, or critically undercapitalized] or the amount necessary to bring the Bank into compliance with all capital standards applicable to the Bank at the time the Bank failed to so comply.

4. Grant of Security Interest. To secure its performance under this Agreement and to provide adequate assurance of performance, as required under 12 U.S.C. § 1831o, the Guarantor has entered into a security agreement pledging certain specified assets of the Guarantor on behalf of the Bank. The Security Agreement is attached hereto as Exhibit B and incorporated herein by reference.

5. Authority of Guarantor. The Board of Directors of the Guarantor have entered into a resolution ("Resolution") certifying that the Guarantor is authorized to enter into this Agreement. A certified copy of the Resolution is attached hereto as Exhibit C and incorporated herein by reference.

6. Miscellaneous.

A. Legally Binding, Enforceable Commitment. The parties agree that the Agreement is a binding and enforceable contractual commitment.

B. Conservatorship or Receivership of the Bank. This Agreement shall survive the appointment of a conservator or receiver for the Bank and shall continue as a binding contractual commitment of the Guarantor, its successors and assigns.

C. Governing Laws. This Agreement and the rights and obligations hereunder shall be governed by and shall be construed in accordance with the federal law of the United States, and, in the absence of controlling federal law, in accordance with the laws of the State of [INSERT STATE].

D. No Waiver. No failure or delay on the part of the Bank in the exercise of any right or remedy shall operate as a waiver or forbearance thereof, nor shall any partial exercise of any right or remedy preclude other or further exercise of any other right or remedy.

E. Fees and Expenses. The Guarantor shall pay any attorneys' fees and other reasonable expenses incurred by the Bank in exercising its rights or seeking any remedies hereunder.

F. Severability. In the event any one or more of the provisions contained herein should be held invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired thereby. The parties shall endeavor in good faith negotiations to replace the invalid, illegal or unenforceable provisions with valid provisions the economic effect of which comes as close as possible to that of the invalid, illegal or unenforceable provisions.

G. No Oral Change. This Agreement may not be modified, amended, changed, discharged, or terminated orally, but may be done so only by an agreement and signed by the party against

whom the enforcement of the modification, amendment, change, discharge or termination is sought.

H. Multiple Guarantors. The Bank may, in its discretion, enforce this Agreement against any and all Guarantors.

I. Modification. This Agreement (and the accompanying Security Agreement, if any) reflects the complete and full agreement entered among the parties and may not be modified, released, renewed or extended in any manner except by a writing signed by all the parties and unless such modification is approved by the OCC in writing.

J. Authority to Execute. Each of the undersigned warrants that he or she is duly authorized to execute the Agreement and to bind the parties to the Agreement. Each of the undersigned acknowledges that this Agreement is binding without reference to whether it is signed by any other person or persons.

K. Addresses for Notice. Any notice hereunder shall be in writing and shall be delivered by hand or sent by United States express mail or commercial express mail, postage prepaid, and addressed as follows:

If to the Bank: [INSERT BANK ADDRESS]

If to the Guarantor: [INSERT GUARANTOR ADDRESS]

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the day and year first above written.

By: _____
[INSERT BANK NAME and TITLE]

By: _____
[INSERT GUARANTOR NAME and TITLE]

Appendix D: Sample Capital Call Agenda and Capital Analysis Worksheet

Agenda

Introduction and Purpose of Meeting

- Introductions of all parties present from the bank and the OCC.
- Inform the bank that this is an official meeting of the board.
- Request that the bank send the OCC a copy of the minutes.
- Inform the board of the examination findings, particularly with respect to the bank's capital support. Request the status of plans to obtain additional capital. Describe what will occur after this meeting. Answer any board questions.

Sample opening script: *Because of losses identified during the exam, the bank is critically undercapitalized. Based on supervisory conclusions through today, the OCC has the legal basis to place the bank into receivership. Time is of the essence. The OCC is open to any viable and realistic plan to restore the bank to adequately capitalized or result in the acquisition or liquidation of the bank. The OCC can stop the process at any time up to the moment that the bank is placed into receivership. We prefer the board to find an "open bank" resolution (recapitalization, merger, or liquidation) that does not require receivership.*

- Discuss what the OCC means by a "viable and realistic capital plan," especially the need to file whatever action is necessary to effect the recapitalization versus an expression of interest.
- Note that examiners have reviewed the bank's losses and credit loss allowance to ensure that the credit loss allowance and losses have been properly classified consistent with regulatory and accounting requirements.

Examination review

- Provide an overview of the examination scope.
- Discuss status of enforcement actions, violations of laws and regulations, concerns in MRAs, and any other significant items.

Capital analysis

- Distribute and discuss capital analysis worksheet.
- Request an update from the board on capital plans.

FDIC process and access resolution

The FDIC needs to prepare early for an orderly resolution at the least cost to the DIF. The FDIC provides a description of the process and related items, including deposit and loan

downloads, the bid package, confidentiality, due diligence, and closing. Potential failed bank acquirers need more information and, therefore, need the board to sign the access resolution. The FDIC describes the process, options, and general time frames. At the end of the meeting, the FDIC distributes the access resolution for board signature.

Closing items

- Reiterate the sensitivity and confidentiality of the process.
- The board and management should prepare for rumors and speculation in the local community that could strain liquidity. Therefore, the board and management should ensure sufficient liquidity monitoring.
- Discuss uninsured deposits, legal lending limits, and call report accuracy.
- Remind the board that time is short, but the OCC will review and prefer any realistic and viable plan to resolve the bank without a receivership.
- Provide time for board questions.

Capital Analysis Worksheet

Bank name and charter number:
Capital call meeting date:

Summary of classified and special mention assets	**Special mention**	**Substandard**	**Doubtful**	**Loss**
Loans				
OREO				
Other assets				
Accrued interest				
Total				

Credit Loss Allowance (ALLL or ACL) Based on a review of the loan portfolio and after considering losses charged off at this examination, an adequate credit loss allowance balance equals $ _____	
Capital Analysis (using information as of *(date))*	
Credit loss allowance	
$	Balance on *(date)*
$	Less: Examination loan losses
$	Balance after loan losses
$	Add: Provision expense needed to restore credit loss allowance adequacy
$	Ending credit loss allowance balance
Tangible equity capital (as defined in 12 CFR. 6.2)	
$	Balance on *(date)*
$	Less: Losses charged to retained earnings
$	Balance after losses
$	Less: Provision expense needed to restore credit loss allowance adequacy
$	Ending tangible equity capital balance
$	Total assets on *(date, after loan and OREO losses)*

%	**Ending tangible equity capital ratio**
Equity capital needed to restore minimum adequate capital support	
$	Total assets on *(date)*
% x .0X	Minimum percent of assets needed as equity capital (per the enforcement action)
$	Minimum required equity capital balance
$	Less: Ending tangible equity capital balance
$	**Required capital injection to restore minimum adequate capital**

This amount represents the equity capital injection necessary to achieve minimum capital adequacy today. This amount may not represent the total injection necessary to ensure long-term viability of the bank. Additional capital injections may be necessary.

Appendix E: Sample Closing Questionnaire

Closing Questionnaire
for OCC Senior Deputy Comptroller [full position]
[name], Decision Maker

[Bank name, city, state, charter number]

EIC:_____ PBS:_____

Please provide me with some facts:

Question	Answer
Has the bank completed its business day and is the lobby secured?	
What is the bank's total risk-based capital ratio as of [date], as defined in 12 CFR 6.2?	
What is the bank's tier 1 risk-based capital ratio as of [date], as defined in 12 CFR 6.2?	
What is the bank's common equity tier 1 risk-based capital ratio as of [date], as defined in 12 CFR 6.2?	
What is the bank's leverage ratio as of [date], as defined in 12 CFR 6.2?	
What is the bank's ratio of tangible equity to total assets as of [date], as defined in 12 CFR 6.2?	
Include the following two questions as appropriate based on the bank's PCA category	
Have the bank's capital ratios improved since [date], such that the bank would no longer be considered undercapitalized as defined in 12 CFR 6.4(b)(3)?	
Has the bank's capital ratio improved since [date], such that the bank would no longer be considered critically undercapitalized as defined in 12 CFR 6.4(b)(5)?	
Include the following questions as appropriate based on the receivership grounds	
Are the bank's assets less than the bank's obligations to its creditors and others, including members of the bank? (12 USC 1821(c)(5)(A))	
Has the bank experienced substantial dissipation of assets or earnings due to any violation of any statute or regulation? (12 USC 1821(c)(5)(B)(i))	
Has the bank experienced substantial dissipation of assets or earnings due to any unsafe or unsound practice? (12 USC 1821(c)(5)(B)(ii))	

Question	Answer
Is the bank in an unsafe or unsound condition to transact business? (12 USC 1821(c)(5)(C))	
Has the bank committed any willful violation of a cease-and-desist order that has become final? (12 USC 1821(c)(5)(D))	
Is there any concealment of the bank's books, papers, records, or assets, or any refusal to submit the bank's books, papers, records, or affairs for inspection to any examiner or to any lawful agent of the OCC? (12 USC 1821(c)(5)(E))	
Is the bank likely to be unable to pay its obligations or meet its depositors' demands in the normal course of business? (12 USC 1821(c)(5)(F))	
Has the bank incurred or is it likely to incur losses that will deplete all or substantially all of its capital, and is there no reasonable prospect for the bank to become adequately capitalized (as defined in 12 USC 1831o(b)) without federal assistance? (12 USC 1821(c)(5)(G))	
Is there any violation of any law or regulation, or any unsafe or unsound practice or condition [include preceding items as appropriate] that is likely to cause insolvency or substantial dissipation of assets or earnings? (12 USC 1821(c)(5)(H)(i))	
Is there any violation of any law or regulation, or any unsafe or unsound practice or condition [include preceding items as appropriate] that is likely to weaken the bank's condition? (12 USC 1821(c)(5)(H)(ii))	
Is there any violation of any law or regulation, or any unsafe or unsound practice or condition [include preceding items as appropriate] that is likely to seriously prejudice the interests of the bank's depositors or the Deposit Insurance Fund? (12 USC 1821(c)(5)(H)(iii))	
Has the bank, by resolution of its board of directors or its shareholders or members [include preceding items as appropriate], consented to the appointment of a receiver? (12 USC 1821(c)(5)(I))	
Has the bank ceased to be an insured institution? (12 USC 1821(c)(5)(J))	
Is the bank undercapitalized (as defined in 12 USC 1831o(b)), and does the bank have no reasonable prospect of becoming adequately capitalized (as defined in 12 USC 1831o)? (12 USC 1821(c)(5)(K)(i))	

Question	Answer
Is the bank undercapitalized (as defined in 12 USC 1831o(b)), and has the bank failed to become adequately capitalized when required to do so under 12 USC 1831o(f)(2)(A)? (12 USC 1821(c)(5)(K)(ii))	
Is the bank undercapitalized (as defined in 12 USC 1831o(b)), and has the bank failed to submit a capital restoration plan acceptable to the Office of the Comptroller of the Currency within the time prescribed under 12 USC 1831o(e)(2)(D)? (12 USC 1821(c)(5)(K)(iii))	
Is the bank undercapitalized (as defined in 12 USC 1831o(b)), and has the bank materially failed to implement a capital restoration plan submitted and accepted under 12 USC 1831o(e)(2)? (12 USC 1821(c)(5)(K)(iv))	
Is the bank critically undercapitalized (as defined in 12 USC 1831o(b))? (12 USC 1821(c)(5)(L)(i))	
Does the bank otherwise have substantially insufficient capital? (12 USC 1821(c)(5)(L)(ii))	
Has the Attorney General provided written notice to the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation [include agency as appropriate] that the bank has been found guilty of a criminal offense under 18 USC 1956, 18 USC 1957, 31 USC 5322, or 31 USC 5324? (12 USC 1821(c)(5)(M))	
For national banks only: Does the bank's board of directors comprise fewer than five members, and has the Comptroller of the Currency provided 30 days' notice of the violation? (12 USC 71a, 191(a)(2))	

Pursuant to the authority the Comptroller of the Currency has delegated to me to appoint a receiver [insert applicable text: for a national bank under 12 USC 191 / for a federal savings association under 12 USC 1464(d)(2)] and 1821(c)(5), I hereby appoint the Federal Deposit Insurance Corporation (FDIC) receiver for [bank name, city, state]. Please deliver the appropriate closing documents to the bank and the FDIC.

Signature: _____ *Date and time:* _____

[name]
[position]

Appendix F: Abbreviations

ACL	allowance for credit losses
AFS	available for sale
ALLL	allowance for loan and lease losses
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
call report	Consolidated Reports of Condition and Income
CAMELS	capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk
CECL	current expected credit losses
CET1	common equity tier 1 capital
CFP	contingency funding plan
CFR	Code of Federal Regulations
CIDI	covered insured depository institution
CMP	civil money penalty
CRP	capital restoration plan
CSA	covered savings association
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DTA	deferred tax asset
EIC	examiner-in-charge
FBO	foreign banking organization
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FIL	Financial Institution Letter
FSA	federal savings association
G-SIB	global systemically important bank
G-SIFI	global systemically important financial institution
GAAP	generally accepted accounting principles
HFS	held for sale
HTM	held to maturity
IAP	institution-affiliated party
IMCR	individual minimum capital ratio
IRR	interest rate risk
MRA	matters requiring attention
MSA	mortgage servicing asset
MSR	mortgage servicing rights
NOL	net operating loss
OCC	Office of the Comptroller of the Currency
OREO	other real estate owned
P&A	purchase and assumption
PBS	problem bank specialist
PCA	prompt corrective action
PCI	purchased credit-impaired
PPM	*Policies and Procedures Manual*

RAS	risk assessment system
RBC	risk-based capital
ROCA	risk management, operational controls, compliance, and asset quality
ROE	report of examination
SLR	supplementary leverage ratio
TDR	troubled debt restructuring
UCC	Uniform Commercial Code
USC	U.S. Code

References

Listed references apply to national banks and FSAs unless otherwise noted.

Laws

12 USC 161, "Reports to Comptroller of the Currency" (national banks)
12 USC 191, "Appointment of Receiver for a National Bank" (national banks)
12 USC 203, "Appointment of Conservator"
12 USC 371b-2, "Interbank Liabilities"
12 USC 371c, "Banking Affiliates"
12 USC 371c-1, "Restrictions on Transactions With Affiliates"
12 USC 376, "Preferential Interest Payments" (national banks)
12 USC 481, "Appointment of Examiners; Examination of Member Banks, State Banks, and Trust Companies; Reports" (national banks)
12 USC 1464(d), "Regulatory Authority" (FSAs)
12 USC 1464(t), "Capital Standards" (FSAs)
12 USC 1464(v), "Reports of Condition" (FSAs)
12 USC 1813(u), "Institution-Affiliated Party"
12 USC 1815(e), "Liability of Commonly Controlled Depository Institutions"
12 USC 1817(b)(1)(C), "Risk-Based Assessment System Defined"
12 USC 1818, "Termination of Status as Insured Depository Institution"
12 USC 1821(a)(1)(D), "Coverage for Certain Employee Benefit Plan Deposits"
12 USC 1821(c), "Appointment of Corporation as Conservator or Receiver"
12 USC 1828(z), "General Prohibition on Sale of Assets"
12 USC 1829, "Penalty for Unauthorized Participation by Convicted Individual"
12 USC 1831f, "Brokered Deposits"
12 USC 1831o, "Prompt Corrective Action"
12 USC 1841, "Definitions"
12 USC 1867(c), "Services Performed by Contract or Otherwise"
12 USC 3102(j), "Receivership Over Assets of Foreign Bank in United States" (uninsured federal branches)
12 USC 3907, "Capital Adequacy"
18 USC 1517, "Obstructing Examination of Financial Institution"

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12 CFR 3, "Capital Adequacy Standards"
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12 CFR 6, "Prompt Corrective Action"
12 CFR 19, subpart M (national banks)
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12 CFR 28.15, "Capital Equivalency Deposits" (insured federal branches)

12 CFR 28.20, "Maintenance of Assets" (insured federal branches)
12 CFR 30, appendix A, "Interagency Guidelines Establishing Standards for Safety and Soundness"
12 CFR 31.2, "Insider Lending Restrictions and Reporting Requirements"
12 CFR 34, subpart C, "Appraisals"
12 CFR 51, "Receiverships for Uninsured National Banks" (uninsured national banks)
12 CFR 101, "Covered Savings Associations" (CSAs)
12 CFR 165.8, "Procedures for Reclassifying a Federal Savings Association Based on Criteria Other Than Capital" (FSAs)
12 CFR 165.9, "Order to Dismiss a Director or Senior Executive Officer" (FSAs)
12 CFR 201, "Extensions of Credit By Reserve Banks (Regulation A)"
12 CFR 206, "Limitations on Interbank Liabilities (Regulation F)"
12 CFR 215, "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation O)"
12 CFR 223, "Transactions Between Member Banks and Their Affiliates (Regulation W)"
12 CFR 303.243, "Brokered Deposit Waivers"
12 CFR 303.244, "Golden Parachute and Severance Plan Payments"
12 CFR 327, "Assessments"
12 CFR 337.6, "Brokered Deposits"
12 CFR 337.7, "Interest Rate Restrictions"
12 CFR 347.209, "Pledge of Assets" (insured federal branches)
12 CFR 347.210, "Asset Maintenance" (insured federal branches)
12 CFR 359, "Golden Parachute and Indemnification Payments"

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"Large Bank Supervision"
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"Capital and Dividends"
"Concentrations of Credit"
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"Country Risk Management"
"Insider Activities"
"Interest Rate Risk"
"Internal and External Audits"
"Liquidity"
"Mortgage Banking"

"Other Real Estate Owned"
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