FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10552**
July 13, 1992]

Proposals To Implement Prompt Corrective Action For Undercapitalized State Member Banks

Comments Invited by August 14

To All State Member Banks, and Bank Holding Companies, in the Second Federal Reserve District:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has requested public comment on proposals to implement prompt corrective action for undercapitalized State member banks in accordance with Section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which amended Section 38 of the Federal Deposit Insurance Act.

Comments should be received by August 14, 1992.

These proposals to revise the Board's Regulation H (Membership of State Banking Institutions in the Federal Reserve System) would:

- Adopt definitions of the capital measures and capital thresholds for each of the five capital categories established in the statute;
- Establish a schedule for filing and review of capital restoration plans required to be filed by undercapitalized institutions;
- Clarify certain aspects of the capital guarantee required to be made by any company that controls an undercapitalized institution as part of an acceptable plan;
- Establish a procedure for providing institutions with notice of, and an opportunity to respond to, a proposed agency directive to apply supervisory requirements committed by the statute to agency discretion;
- Establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital; and
- Establish procedures by which senior executive officers and directors who are ordered dismissed by the Board may petition for reinstatement.

The Board has developed this proposal in consultation with the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation.

Printed on the following pages are tables that summarize the general statutory definitions of capital categories for prompt corrective action. In addition, enclosed, for State member banks and bank holding companies in this District, is the text of the Board's proposals as published in the *Federal Register* of July 1; additional, single copies can be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling our Circulars Division (Tel. No. 212-720-5215 or 5216).

Comments on the proposals should be submitted by August 14, 1992, and may be sent to the Board, as indicated in the notice, or to this Bank, to Manuel J. Schnaidman, Manager, Bank Analysis Department (Tel. No. 212-720-6710).

E. GERALD CORRIGAN,
President.

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TABLE 1

GENERAL STATUTORY DEFINITIONS OF CAPITAL CATEGORIES FOR PROMPT CORRECTIVE ACTION

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CAPITAL CATEGORY	STATUTORY DEFINITION
WELL CAPITALIZED	Capital ratios significantly exceed minimums for each specified capital standard
ADEQUATELY CAPITALIZED	Capital ratios meet minimums for each specified capital standard
UNDERCAPITALIZED	Capital ratios fail to meet minimums for any specified capital standard
SIGNIFICANTLY UNDERCAPITALIZED	Capital ratios are significantly below minimums of any specified capital standard
CRITICALLY UNDERCAPITALIZED	A ratio of tangible equity to total assets of 2 percent or less

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TABLE 2

MANDATORY SUPERVISORY ACTIONS APPLICABLE TO INSTITUTIONS IN THE VARIOUS CAPITAL CATEGORIES

Well Capitalized and Adequately Capitalized

May not make any capital distribution or pay a management fee to a controlling person that would leave the institution undercapitalized.

Undercapitalized

Subject to provision applicable to well capitalized and adequately capitalized.

Subject to increased monitoring.

Must submit an acceptable capital restoration plan within 45 days and implement that plan.

Growth of total assets must be restricted.

Prior approval from the appropriate agency is required prior to acquisitions, branching, and new lines of business.

Significantly Undercapitalized

Subject to all provisions applicable to undercapitalized institutions.

Bonuses and raises to senior executive officers must be restricted.

Subject to at least one of the discretionary actions presented on Table 3.

Critically Undercapitalized

Must be placed in receivership within 90 days unless the appropriate agency and the FDIC concur that other action would better achieve the purposes of prompt corrective action.

Must be placed in receivership if it continues to be critically undercapitalized, unless specific statutory requirements are met.

After 60 days, must be prohibited from paying principal or interest on subordinated debt without prior approval of the FDIC.

Activities must be restricted. At a minimum, may not do the following without the prior written approval of the FDIC:

Enter into any material transaction other than in the usual course of business.

Extend credit for any HLT.

Make any material change in accounting methods.

Engage in any "covered transactions" as defined in section 23A of the Federal Reserve Act, which concerns affiliate transactions.

Pay excessive compensation or bonuses.

Pay interest on new or renewed liabilities at a rate that would cause the weighted average cost of funds to significantly exceed the prevailing rate in the institution's market area.

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TABLE 3

DISCRETIONARY SUPERVISORY ACTIONS APPLICABLE TO INSTITUTIONS IN THE VARIOUS CAPITAL CATEGORIES

Well Capitalized and Adequately Capitalized

None.

Undercapitalized

Subject to any discretionary actions applicable to significantly undercapitalized institutions if the appropriate agency determines that those actions are necessary to carry out the purposes of prompt corrective action.

Significantly Undercapitalized

Actions the institution is presumed subject to unless the appropriate agency determines that such action would not further the purpose of prompt corrective action:

Must raise additional capital or arrange to be merged with another institution.

Transactions with affiliates must be restricted by requiring compliance with section 23A of the Federal Reserve Act as if exemptions of that section did not apply.

Interest rates paid on deposits must be restricted to prevailing rates in the region.

Significantly Undercapitalized (Cont.)

Other discretionary actions:

Severe restriction on asset growth or reduction of total assets may be required.

Institution or its subsidiaries may be required to terminate, reduce, or alter any activity determined to pose excessive risk.

May be required to hold a new election of its board of directors.

Dismissal of any director or senior executive officer and their replacement by new officers subject to agency approval may be required.

May be prohibited from accepting deposits from correspondent depository institutions.

Controlling BHC may be prohibited from paying dividends without prior Federal Reserve approva

May be required to divest or liquidate any subsidiary in danger of becoming insolvent and posing a significant risk to the institution.

Any controlling company may be required to divest or liquidate any nondepository institution affiliate in danger of becoming insolvent and posing a significant risk to the institution.

May be required to take any other action that th appropriate agency determines would better car out the purposes of prompt corrective action.

Critically Undercapitalized

Additional restrictions (other than those mandated) may be placed on activities.

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TABLE 4

PROPOSED SPECIFICATIONS OF CAPITAL ZONES FOR PROMPT CORRECTIVE ACTION
(in percent)

	Total Risk-Based Ratio		Tier 1 Risk-Based Ratio		Tier 1 Leverage Ratio		Capital Directive/Other
Well Capitalized	10 or above	&	6 or above	&	5 or above	&	Not subject to a capital directive to meet a specific level for any capital measure
Adequately Capitalized	8 or above	&	4 or above	&	4 or above[1]	&	Does not meet the definition of well capitalized
Under Capitalized	Under 8	or	Under 4	or	Under 4[2]		
Significantly Under Capitalized	Under 6	or	Under 3	or	Under 3		
Critically					2 or under[3]		

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[1] 3 percent or above for composite 1-rated banks and savings associations that are not experiencing or anticipating significant growth.

[2] Under 3 percent for composite 1-rated banks and savings associations that are not experiencing or anticipating significant growth.

[3] Section 131 of FDICIA specifies that an insured depository institution shall be deemed to become critically undercapitalized when its ratio of tangible equity to total asset is 2 percent or less. It is proposed that the Tier 1 leverage ratio be used for this capital measure.

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Proposals Regarding Prompt Corrective Action for Undercapitalized Institutions

Docket No. R-0763

Comments Invited by August 14, 1992

[Enc. Cir. No. 10552]

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FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 263

[Docket No. R-0763; Regulation H]

Membership of State Banking Institutions in the Federal Reserve System; Rules of Practice for Hearings; Prompt Corrective Action

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is proposing to revise Regulation H to implement for state member banks the system of prompt corrective action established by section 38 of the Federal Deposit Insurance Act (FDI Act) as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Section 38 requires each federal banking agency to implement prompt corrective action for the institutions that it regulates. The Board is also proposing to revise its rules of practice for hearings to establish procedures for the issuance of directives and other actions required under prompt corrective action.

Section 38 requires or permits the Board to take certain supervisory actions when a state member bank falls within one of five specifically enumerated capital categories. It also restricts or prohibits certain activities and requires the submission of a capital restoration plan when an insured institution becomes undercapitalized. The proposed amendments to the Board's regulations are necessary to establish the capital levels at which state member banks will be deemed to come within the five capital categories. The proposed amendments also establish procedures for issuing and contesting prompt corrective action directives including directives requiring the dismissal of directors and senior executive officers.

The Board is seeking comment on all aspects of its proposal.

DATES: Written comments must be received on or before August 14, 1992.

ADDRESSES: Comments, which should refer to Docket No. R-0763, may be mailed to Mr. William Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Comments addressed to Mr. Wiles may also be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in room B-1122 between 9 a.m. and 5 p.m., except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Frederick M. Struble, Associate Director (202/452-3794), Norah Barger, Supervisory Financial Analyst (202/452-2402), Division of Banking Supervision and Regulation; Scott G. Alvarez, Associate General Counsel (202/452-3583), Gregory A. Baer, Senior Attorney (202/452-3236), Legal Division; Myron L. Kwast, Assistant Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

I. Background

Section 131 of FDICIA, Public Law 102-242, created a new statutory framework that applies to every insured depository institution a system of supervisory actions indexed to the capital level of the individual institution. The stated purpose of this statutory provision is to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund. The new framework is contained in section 38 of the FDI Act. This framework and the authority it confers on the federal banking agencies are meant to supplement the existing supervisory authority vested in the agencies, and do not limit in any way their existing authority under other statutes or regulations to initiate supervisory actions to address capital deficiencies, unsafe or unsound conduct, practices, or conditions, or violations of law.

Section 38 requires the federal banking agencies, within 9 months of the enactment of FDICIA, to promulgate final regulations necessary to carry out the purposes of that section. Under the statute, these regulations must become effective within one year after the date of enactment of FDICIA, or no later than December 19, 1992.

It is the goal of the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS") to promulgate uniform regulations to the extent feasible in implementing the prompt corrective action framework of section 38. The agencies believe that a uniform approach to capital definitions and capital categories would simplify the tasks facing bank and thrift management of monitoring and maintaining the capital levels of insured depository institutions, and would remove any competitive distortions that might arise if different standards were applied to competing institutions.

In order to implement the provisions of section 38, the agencies have proposed regulations that have uniform provisions. The agencies propose to define in the same manner the capital measures and capital thresholds for each of the five capital categories established in the statute. The agencies also propose to establish a uniform schedule for filing and review of capital restoration plans. In addition, the agencies propose to adopt identical provisions clarifying certain aspects of the capital guarantee required to be made by companies that control an undercapitalized institution as part of an acceptable capital plan, including the limit on the liability of such companies.

The agencies' proposal establishes a procedure under which institutions are provided advance notice of a proposed agency action under section 38 and provided an opportunity to respond to the proposed action. A separate procedure is proposed that governs decisions by the appropriate federal banking agency to change the capital category to which the institution is assigned after review of supervisory factors other than capital. Finally, the proposal implements the statutory requirement that officers and directors who are subject to dismissal as a result of an agency order issued under section 38 be afforded agency review of the dismissal.

Many of the provisions of section 38 apply without the need for agency action, or impose requirements or limitations on an agency in the exercise of its discretion. These provisions have not been repeated in the proposed regulation. The proposal implements only those portions of section 38 that the agencies believe require regulatory specification or clarification.

Where procedures have not been established in this proposal, such as procedures for review of a stock redemption or an expansion proposal by an undercapitalized institution, each agency will implement a procedure governing agency review. Such procedures will be established by regulation or through instructions to its appropriate field offices or examiners and to the institutions involved. In

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several instances, procedures governing agency review have already been established in other agency regulations.

The agencies request comment on all aspects of this proposal, including the specific numbered questions presented below. In addition, the agencies request comment on whether other provisions of section 38 require clarification or should be implemented by regulation. The agencies stress that comments may address any aspect of the proposal and need not be confined to the numbered questions set out below. Commenters are invited to submit comments to any or all of the federal banking agencies.

II. Summary of Statutory Framework

The following is a brief summary of the supervisory framework established by section 38. This summary has been prepared in order to give context to the agency proposal and request for comment. The summary is not intended to be complete description of the requirements of section 38, and commenters may find it useful to consult the provisions of section 38, contained at 12 U.S.C. 1831o, in preparing their comments.

Section 38 provides a framework of supervisory actions based on the capital level of an insured depository institution. Section 38 establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The statute deems an insured depository institution to be:

Well capitalized if the institution significantly exceeds the required minimum level for each relevant capital measure;

Adequately capitalized if the institution fails to meet the required minimum level for any relevant capital measure;

Undercapitalized if the institution fails to meet the required minimum level for any relevant capital measure;

Significantly undercapitalized if the institution is significantly below the required minimum level for any relevant capital measure; or,

Critically undercapitalized if the institution has a ratio of tangible equity to total assets of 2 percent or less, or otherwise fails to meet the critical capital level established pursuant to section 38(c)(3)(A).

The applicability of supervisory actions provided in section 38 to an individual institution depends on the institution's classification within one of these five categories.

A. Provisions Applicable to All Institutions

Section 38 prohibits are insured depository institution from declaring any individuals, making any other capital distribution, or paying a management fee to a controlling person if, following the distribution or payment, the institution would be within any of the three undercapitalized categories. The statute provides a limited exception to this prohibition for stock redemptions that do not result in any decrease in an institution's capital and would improve the institution's financial condition provided the redemption has been approved by the institution's appropriate federal banking agency after consultation with the FDIC.

B. Provisions Appliable to Undercapitalized Institutions

Institutions that are classified as undercapitalized are subject to a number of additional mandatory supervisory actions. These include.

- Increased monitoring by the appropriate federal banking agency for the institution and periodic review of the institution's efforts to restore its capital;
- A requirement that the institution submit, generally within 45 days, a capital restoration plan acceptable to the appropriate federal banking agency for the insitution and implement that plan;
- A restriction on growth of the institution's total assets; and
- A limitation on the institution's ability to make any acquisition, open any new branch offices, or engage in any new line of business without the prior approval of the appropriate federal banking agency for the institution.

Section 38 also provides that the appropriate federal banking agency for an undercapitalized institution may take any a number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund. These discretionary supervisory actions include requiring the institution to raise additional capital, restricting transactions with affiliates, restricting interest rates paid by the institution on deposits, requiring replacement of senior executive officers and directors, restricting the activities of the institution and its affiliates, requiring divestiture of the institution or the sale of the institution to a willing purchaser, and any other supervisory action that the agency deems appropriate. Because these discretionary actions are also applicable to significantly undercapitalized institutions (as well as to critically undercapitalized institutions), these actions are described more fully in the next section.

C. Provisions Applicable to Significantly Undercapitalized Institutions

Section 38 provides that significantly undercapitalized institutions are subject to the four mandatory provisions listed above that are applicable to undercapitalized institutions. Sections 38 also provides that a significantly undercapitalized institution must restrict the payment of bonuses and raises to senior executive officers of the institution.

In addition to these mandatory requirements, section 38 specifies that the appropriate federal banking agency for the institution shall impose one or more restrictions on an institution that is significantly undercapitalized. These discretionary actions include:

- Requiring the institution to sell enough additional capital, including voting shares, so that the institution would be adequately capitalized after the sale;
- Restricting transactions between the institution and its affiliates, including transactions with its insured depository institution affiliates;
- Restricting the interest rates paid on deposits collected by the institution to the prevailing rates in the region where the institution is located;
- Restricting the institution's asset growth or requiring the institution to reduce its total assets;
- Requiring the institution or any subsidiary of the institution to terminate, reduce or alter any activity that the agency determines poses excessive risk to the institution;
- Requiring the institution to hold a new election of its board of directors;
- Requiring the institution to dismiss any director or senior executive officer who had held office at the institution for more than 180 days immediately before the institution became undercapitalized if the agency deems such dismissal to be appropriate, and to employ new officers who may be subject to agency approval;
- Prohibiting the institution from accepting deposits from correspondent depository institutions;
- Prohibiting any bank holding company that controls the institution from making any dividend payment without prior approval of the Federal Reserve Board;
- Requiring the institution to accept an offer to be acquired by another institution or company, or requiring any company that controls the institution to divest the institution;
- Requiring the institution to divest or liquidate any subsidiary that is in danger of becoming insolvent and poses a significant risk to the institution, or

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that is likely to cause significant dissipation of the institution's assets or earnings;

• Requiring any company that controls the institution to divest or liquidate any affiliate of the institution (other than another insured depository institution) if the appropriate federal banking agency for the holding company determines that the affiliate is in danger of becoming insolvent and poses a significant risk to the institution, or is likely to cause significant dissipation of the institution's assets or earnings; and

• Requiring the institution to take any other action that the agency determines would better carry out the purposes of section 38.

While the statute generally provides the agency with discretion to determine whether these actions are appropriate in connection with a particular institution, the statute establishes certain presumptions and requirements with respect to the agency's consideration of these actions. Section 38 requires that the agency take at least one of the above discretionary supervisory actions in connection with every institution that is significantly undercapitalized or critically undercapitalized. The statute also establishes a presumption that the agency require each significantly undercapitalized or critically undercapitalized institution to (1) be acquired by another institution or company or sell sufficient shares to restore the institution's capital to at least the minimum acceptable capital level, (2) restrict transactions with affiliates of the institution, including transactions with depository institution affiliates, and (3) restrict interest rates paid by the institution on deposits. The agency must impose each of these three actions unless the agency determines that the action would not further the purpose of section 38.

As discussed above, each of the discretionary actions listed above may also be taken in connection with undercapitalized institutions if a finding is made by the agency that the action is necessary to carry out the purposes of section 38. In addition, these discretionary actions may be taken in connection with any undercapitalized institution that fails to submit or materially implement a capital restoration plan, as if the institution were a significantly undercapitalized institution.

In addition to the discretionary actions discussed above, section 38 also provides that the appropriate federal banking agency may require a significantly undercapitalized institution or an undercapitalized institution that has failed to submit or implement an acceptable capital restoration plan to comply with one or more of the restrictions established by the FDIC on the activities of critically undercapitalized institutions.

D. Provisions Applicable to Critically Undercapitalized Institutions

Section 38 requires that an insured depository institution that is critically undercapitalized be placed in conservatorship or receivership within 90 days, unless the appropriate federal banking agency for the institution and the FDIC concur that other action would better achieve the purposes of section 38. A determination by the agency to defer placing a critically undercapitalized institution in receivership or conservatorship must be reviewed every 90 days and must document the reasons the agency believes other action would better achieve the purposes of section 38.

The statute requires that the institution be placed in receivership if the institution continues to be critically undercapitalized on average during the fourth quarter after the institution initially became critically undercapitalized, unless certain specific statutory requirements are met. To be eligible for the exception, the institution must (1) have positive net worth, (2) be in substantial compliance with an approved capital restoration plan, (3) be profitable or have an upward trend in earnings, and (4) have reduced its ratio of nonperforming loans to total loans. In addition, the head of the appropriate federal banking agency for the institution and the Chairperson of the FDIC must both certify that the institution is viable and not expected to fail.

Critically undercapitalized institutions are also prohibited, beginning 60 days after becoming critically undercapitalized, from making any payment of principal or interest on subordinated debt issued by the institution without the prior approval of the FDIC. Section 38 does not prevent unpaid interest from accruing on subordinated debt under the terms of the debt instrument.

Section 38(i) of the FDI Act also provides that the FDIC, by regulation or order, must restrict the activities of critically undercapitalized institutions. At a minimum, the FDIC must prohibit a critically undercapitalized institution from doing any of the following without the prior written approval of the FDIC:

• Entering into any material transaction other than in the usual course of business. Such activities include any investment, expansion, acquisition, sale of assets or other similar action where the institution would have to notify its appropriate federal banking agency;

• Extending credit for any highly leveraged transaction;

• Amending the institution's charter or bylaws unless required to do so in order to carry out any other requirement of any law, regulation or order;

• Making any material change in its accounting methods;

• Engaging in any "covered transactions" within the meaning of § 23A(b) of the Federal Reserve Act (12 U.S.C. 371c), which concerns affiliate transactions;

• Paying excessive compensation or bonuses; and

• Paying interest on new or renewed liabilities at a rate which would increase the institution's weighted average cost of funds to a level significantly exceeding the prevailing rates in the institution's normal market areas.

Pursuant to section 38(j) of the FDI Act, none of these restrictions apply to institutions in conservatorship or to any bridge bank that is wholly owned by the FDIC or the RTC.

Pursuant to section 38(o)(2) of the FDI Act, none of these restrictions shall apply, before July 1, 1994, to any insured savings association if:

(a) The savings association had submitted a plan meeting the requirements of section 5(t)(A)(ii) of the Home Owners' Loan Act;

(b) The Director of OTS had accepted the plan; and

(c) The savings association remains in compliance with the plan or is operating under a written agreement with the appropriate federal banking agency.

III. Proposal and Request for Comment

A. Capital Measures

For purposes of defining each of the capital categories (except for the critically undercapitalized category), section 38(c) requires the agencies to prescribe capital standards that include a leverage limit and a risk-based capital requirement. The agencies may establish additional capital measures for these categories if additional capital measures would serve the purposes of section 38. In addition, section 38 permits the agencies to rescind the leverage limit or the risk-based capital measure if the federal banking agencies concur that either measure is no longer an appropriate means for carrying out the purposes of section 38.

The agencies are proposing to adopt the leverage limit and the total risk-based capital measure in defining the capital categories other than the

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critically undercapitalized category. In addition, the agencies propose to adopt the Tier 1 risk-based capital ratio as a capital measure in defining these capital categories. These measures are generally used by the federal banking agencies in determining the adequacy of capital of insured depository institutions.

Comment 1: The agencies request comment on whether adoption of these three capital measures is appropriate to carry out the purpose of section 38.

The agencies note that the capital requirements applicable to insured depository institutions may be affected by section 305 of FDICIA, which amends section 18 of the Federal Deposit Insurance Act ("FDI Act") to require the agencies to revise their risk-based capital standards to take into account interest rate risk, concentration of credit risk, and the risks of nontraditional activities. The statutory deadline for implementation of these revisions is in June 1993.

As the revisions required under section 18 of the FDI Act are implemented, it might prove necessary of appropriate to review the capital measures and thresholds specified for the various capital categories. In particular, the agencies note that one of the rationales for retaining a leverage ratio after the risk-based capital measure was introduced was that the risk-based capital measure is focused on credit-related risk, and does not explicitly factor in other risks, particularly interest rate risk. The agencies will address in an appropriate and expeditious manner the need for lowering or eliminating the leverage capital component from the definitions of well capitalized, adequately capitalized, undercapitalized, and significantly undercapitalized after the risk-based capital standards have been revised by each Federal banking agency to take account of interest rate risk as required by section 305 of FDICIA.

B. Definition of Capital Terms

The agencies propose to adopt the same definitions of capital terms for purposes of the prompt corrective action provisions of section 38 as are currently used under the capital adequacy guidelines or regulations adopted by the agencies. The definition of the risk-based and leverage capital ratios for purposes of the prompt corrective action subpart would refer to the definitions of Tier 1 capital, total capital, total risk-weighted assets, adjusted total assets, and total assets as those terms are defined in the agencies' current capital adequacy guidelines and regulations. This proposal attempts to reduce complexity that could result from the use of new or modified capital definitions, and to minimize confusion and the possibility that an institution may be uncertain regarding its capital levels for purposes of section 38.

Comment 2: The agencies request public comment regarding whether this approach is appropriate or whether the agencies should modify the existing capital definitions for purposes of applying section 38. If adjustments of modifications to the capital definitions currently used are deemed to be appropriate, the agencies request comment on what type of adjustments or modifications should be made.

Comment 3: The agencies also request comment regarding the appropriate period for calculation of capital levels. Under current practice and requirements, the level of capital of an institution is calculated on the basis of the amount of capital held by the institution on a given day as a ratio of the most recent quarterly average of total assets or quarter-end risk-weighted assets for the institution. A daily calculation of both capital and assets may facilitate prompt action under section 38. However, the agencies note that insured depository institutions are not currently required to make daily calculations of capital, and such a requirement would increase the reporting burden on many institutions. In addition, a daily calculation may distort capital calculations by focusing on individual daily events (such as a decline in the market value of certain investments on a given day) rather than on related actions taken during a given period or remedial actions that are readily available to the institution (such as a decline in market value in one investment followed by a gain realized on the sale of another investment).

Comment 4: The agencies request comment on whether, for purposes of applying the prompt corrective action requirements of section 38, the use of quarterly average total assets or quarter-end risk-weighted assets in calculating capital levels is appropriate, or whether the capital calculations for an institution should be based on an actual daily measure or quarter-end measure of the institution's capital and assets.

Comment 5: The agencies also request comment on whether a daily calculation of total assets and risk-weighted assets is feasible, and whether a requirement that an institution make daily calculations would impose significant added burden on insured depository institutions.

C. Specific Capital Levels for Five Capital Categories

Section 38 requires the agencies to establish specific capital thresholds for each capital category and sets general standards, as described above, for each of these categories. Under these standards, an institution is adequately capitalized if it meets the required minimum level for each relevant capital measure. Thus, capital levels set for the adequately capitalized category generally would be the same as the minimum ratios established under the existing minimum capital adequacy rules and guidelines adopted by the agencies. These minimums are 8 percent for the total risk-based capital ratio, 4 percent for the Tier 1 risked-based capital ratio, and 4 percent for the Tier 1 leverage ratio (3 percent for composite 1-rated banks and savings associations, subject to appropriate federal banking agency guidelines). An institution would have to meet all these minimums in order to be deemed adequately capitalized.

The statute also provides specific guidance as to the capital level for defining a critically undercapitalized institution. Section 38 requires that a critically undercapitalized institution be defined by reference to the institution's ratio of tangible equity to total assets. The statute requires the agencies to establish the threshold ratio for defining a critically undercapitalized institution at no lower than 2 percent. As discussed below, the agencies are proposing that a critically under capitalized institution be defined as any institution that has a Tier 1 leverage ratio of 2 percent or less.

Taking the capital levels for the adequately capitalized and critically undercapitalized categories as benchmarks, the agencies are proposing that the capital levels for the undercapitalized category be defined as any level under 8 percent for the total risk-based capital ratio, under 4 percent for the Tier 1 risk-based capital ratio, or under 4 percent for the Tier 1 leverage ratio (under 3 percent for composite 1-rated banks and savings associations, subject to appropriate federal banking agency guidelines). An institution would be considered undercapitalized if it were below the specified capital level for any of the three capital measures.

Further, the capital levels for significantly undercapitalized institutions would be defined as any level under 6 percent for the total risk-based capital ratio, under 3 percent for the Tier 1 risk-based capital ratio, or under 3 percent for the Tier 1 leverage ratio. An institution would be considered significantly

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undercapitalized if it were below the specified capital level for any of the three capital measures. Under the proposed definitions, an institution that is significantly undercapitalized also would be deemed to be undercapitalized. Similarly, an institution that is critically undercapitalized also would be deemed to be significantly undercapitalized and undercapitalized. The overlap between these categories is contemplated by the statute and has the effect of applying to significantly undercapitalized institutions and to critically undercapitalized institutions any provisions of section 38 that are applicable to undercapitalized institutions.

The agencies are proposing to establish the minimum total risk-based capital level for the well capitalized category at 10 percent and to set the minimum leverage capital level for this category at 5 percent. To emphasize the importance the agencies place on Tier 1 capital, it is proposed that for the well capitalized category the minimum level for the Tier 1 risk-based capital ratio be set at 6 percent. The specifications of the minimum ratios for the well capitalized category are proposed at levels that are 25 percent to 50 percent higher than the minimum for the adequately capitalized category to promote safe and sound banking conditions, giving due consideration to the international capital standards to which the United States and other G–10 countries have agreed, and to the competitive pressures faced by U.S. banks operating in international markets with foreign banks adhering to these standards.

Capital ratios alone, of course, are not fully indicative of the capital strength of an institution. In particular, in proposing these minimum capital levels, the agencies are aware that some poorly-rated depository institutions have capital ratios above the specified minimums for the well capitalized and adequately capitalized categories. One reason that some poorly-rated institutions qualify as well capitalized for prompt corrective action purposes is that capital is a lagging indicator of problems of insured depository institutions.

Some institutions are subject to a written order or directive that establishes a higher capital level for the institution. The agencies are proposing that for an institution to be well capitalized, it must not be subject to any written capital order or directive. This proposal reflects the view that an institution that is subject to a written capital directive from the appropriate federal banking agency does not have capital that significantly exceeds the required minimum level for the relevant capital measures.

The agencies also intend to assess carefully all aspects of a troubled institution's condition, and to exercise their reclassification authority under section 38(g) of FDICIA. Section 38(g) gives the agencies discretion to downgrade, where appropriate, a "well capitalized" institution by one category and require an "adequately capitalized" or "undercapitalized" institution to comply with supervisory actions as if it were in the next lower category if that institution has received a less-than-satisfactory examination rating for asset quality, management, earnings, or liquidity without correcting the deficiency. Any institution would be subject to downgrading on the basis of the components of the institution's examination rating, including an institution that has been deemed not to be within the well capitalized category because the institution is subject to a written capital order or directive.

While the prompt corrective action framework constitutes an additional supervisory tool, the federal banking agencies continue to have available all supervisory tools traditionally used to supervise institutions. The agencies also fully intend to use these tools as appropriate in supervising institutions. These include appropriate enforcement actions and supervisory follow-up measures based upon the institution's overall condition and the existence of any financial, operational, or other supervisory weaknesses, irrespective of the organization's capital category for purposes of the prompt corrective action provisions of section 38.

Accordingly, the assignment of an institution to a particular capital category—including the well capitalized category—does not prevent the appropriate federal banking agency from taking other supervisory action that the agency deems to be appropriate. Moreover, in light of the intended limited purpose of a capital category designation, the agencies are proposing to limit a given insured depository institution's use of its capital category, except when permitted by the appropriate federal banking agency or otherwise required by statute or regulation. This is intended to limit the ability of insured depository institutions to advertise their category.

Comment 6: The agencies invite comment on this limitation on advertising.

Traditionally, examiners have reached judgments on an institution's capital needs by also taking into account a range of factors such as interest rate risk and concentration risk. The agencies have initiatives under way mandated by FDICIA to review their risk-based capital standards to ensure that they take more adequate account of such risks, and also have been engaged in a project under the Federal Financial Institutions Examination Council ("FFIEC") to refine and improve procedures for assessing the reserving policies and practices of individual institutions. After those projects have been completed and improvements implemented and assessed, the agencies intend to revisit the question of how the specifications for the well capitalized category may need to be modified or adjusted.

Comment 7: The agencies request comment on all aspects of the capital levels proposed in the draft regulation

Comment 8: In particular, the agencies seek comment on whether the specific levels set for each capital category are appropriate, as well as whether it is appropriate to require that well-capitalized institutions not be subject to a capital order or directive.

D. Critically Undercapitalized Institutions

The statute requires that the critically undercapitalized category be based on the ratio of tangible equity to total assets of the institution. Section 38 requires that the minimum ratio for this category be established at a level of tangible equity that is no less than 2 percent of the institution's total assets, and that is no higher than the ratio equal to 65 percent of the required minimum level of capital under the leverage limit. The agencies may, be regulation, specify additional capital measures (such as a risk-based capital ratio) in defining the critically undercapitalized category. Any such measures may not, without the concurrence of the FDIC, be set at a level lower than the level specified by the FDIC for insured state-chartered banks that are not members of the Federal Reserve System.

The agencies are proposing to define critically undercapitalized institutions as institutions that have a ratio of Tier 1 capital to total assets of 2 percent or less. The agencies do not at this time propose to establish any additional capital measures for the critically undercapitalized category.

Under this proposal, the agencies would define tangible equity to be Tier 1 capital as defined under the agencies' existing capital adequacy guidelines or regulations. The use of the Tier 1 capital definition has been proposed for several reasons. The definition of Tier 1 capital

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requires a deduction from equity capital for most intangible assets, including goodwill. The use of Tier 1 capital also focuses primarily on common equity rather than other forms of equity and, therefore, represents the most secure form of equity available to absorb losses that may be incurred by an insured depository institution.

In addition, because Tier 1 capital is an element of the existing capital adequacy guidelines and is included in the definition of the other capital measures proposed under section 38, use of the Tier 1 capital definition would promote consistency and simplicity and, therefore, minimize the potential for confusion in the capital computations required to be made by insured depository institutions. It would also reduce the potential for distortion in the capital raising efforts of insured depository institutions and for anomalies in the classification of institutions under section 38 that might result from use of a substantially different definition of capital for the critically undercapitalized category than is used for the other capital categories.

Comment 9: The agencies request public comment on this definition.

Comment 10: The agencies also request comment on whether the definition of tangible equity should reflect additional adjustments to deduct intangible assets. The agencies note that section 475 of FDICIA requires the federal banking agencies to determine whether a portion of certain purchased mortgage servicing rights should be included in the calculation of tangible capital. The agencies also recently sought public comment on a proposal to permit insured depository institutions to include a portion of certain purchased credit-card relationships in the calculation of tangible capital for purposes of meeting applicable minimum capital adequacy standards.

Comment 11: The agencies request comment on whether purchased mortgage servicing rights and purchased credit-card relationships should be excluded from the definition of tangible equity for purposes of section 38.

Similarly, investments in certain types of subsidiaries, which savings associations are required to deduct for purposes of their general capital calculations, represent realizable assets which buffer the exposure of the deposit insurance funds.

Comment 12: The agencies request comment on whether these investments should be deducted in computing the relevant capital ratio for purposes of determining whether an institution is critically undercapitalized.

Comment 13: In addition, the agencies request comment on whether tangible equity should be defined to take into account broader forms of equity beyond those included in the definition of Tier 1 capital.

Comment 14: In particular, the agencies request comment on whether cumulative perpetual preferred stock should be included in determining whether an institution is critically undercapitalized.

Comment 15: Because the agencies are not proposing to include this form of equity in determining whether an institution is critically undercapitalized, the agencies also request comment on whether a transition period should be permitted for institutions that are permitted to rely on cumulative perpetual preferred stock under currently outstanding agency orders.

Comment 16: The agencies also request comment on whether a higher threshold should be established than the proposed 2 percent leverage limit. By statute, this ratio may not exceed 65 percent of the minimum leverage ratio established by the agencies.

Comment 17: Finally, the agencies request comment on whether it is appropriate to establish additional capital measures for the critically undercapitalized category. As noted above, section 38 permits the agencies to establish additional capital measures in defining the critically undercapitalized category. The agencies are proposing the use the total risk-based capital measure and the Tier 1 risk-based capital measure for all other categories, but are not proposing to use these capital measures in defining critically undercapitalized institutions.

E. Calculation of Capital Levels and Notice of Capital Levels

Under the proposal, an institution would be expected to monitor its capital levels continually and to notify the appropriate federal banking agency promptly if the institution's capital levels fall into a lower capital category. In addition, capital levels would be periodically determined on the basis of information filed by each insured depository institution in its quarterly Consolidated Report of Condition and Income ("Call Report"), or on the basis of information obtained in an examination or inspection of the institution. Capital levels may also be determined by the appropriate federal banking agency for an institution on the basis of other information obtained by the agency from any source. This information may include data provided by the institution to the agency on a voluntary basis, information obtained in connection with an application, calculations based on a report that the institution must file other than a Call Report, or adjustments that are appropriate bused on publicly announced events that may affect the institution's capital.

Under the proposal, an institution would be deemed to be aware of information that it files in a Call Report as of the date that the Call Report is required to be filed. Similarly, the institution would be deemed to be notified of capital levels calculated in the examination or inspection process as of the date that the examination report or inspection report is provided to the institution. In the event that the agency determines the capital levels of the institution on the basis of other information, the agencies are proposing to notify the institution in writing of the calculation and the information used as a basis for the capital calculation.

The agencies are concerned that, while the proposed arrangement for calculating the capital levels of an institution on the basis of Call Reports and reports of examination and inspection may be reliable and in most instances timely, this procedure may not always lead to a prompt calculation of capital levels for a given institution. For example, an institution may become aware of information that affects its capital calculation between the time that Call Reports are required to be filed and when an examination is not in process or another report may not be required. This could result in delay in application of the supervisory requirements of section 38, including the provisions that are mandated by the statute.

In order to address changes in capital promptly, the agencies propose to require insured depository institutions to notify the appropriate federal banking agency within 5 days of any event that would cause the institution to be assigned to a different capital category than the category assigned on the basis of the most recent Call Report or report of examination or inspection. The institution would be deemed to be aware of a necessary adjustment when its senior management determines that the adjustment is appropriate, even if the adjustment is not required to be reported in an official report of otherwise disclosed for some period of time. Under the proposal, the agency would review the information provided by the institution, along with any explanation provided by the institution, to determine whether the institution should be assigned to a different capital category for purposes of the provisions of section 38. This procedure would

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apply to both upward and downward adjustments to capital that occur between the filing of Call Reports or examinations.

Comment 18: The agencies invite public comment on all aspects of this approach to the capital calculations.

Comment 19: In particular, the agencies request comment on the use of Call Reports and examination reports as the primary bases for capital calculations.

Comment 20: In addition, the agencies request comment on the procedures that have been proposed for self-monitoring and agency notification of changes in capital levels, including comment on the burden associated with this procedure and comment on whether any other procedure to permit the timely monitoring of an institution's capital levels is appropriate.

F. Reclassification Based on Supervisory Criteria Other Than Capital Standards

Section 38 provides that the appropriate federal banking agency may, under certain circumstances, reclassify a well capitalized insured depository institution as adequately capitalized and require an adequately capitalized or undercapitalized institution to comply with supervisory actions as if it were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution. (Reclassification to the adequately capitalized category and treatment of an institution as if it were in the next lower capital category are referred to collectively herein as a "reclassification.") The statute permits the agency to reclassify an institution where the agency has determined, after notice and opportunity for hearing, that the institution is in unsafe or unsound condition. Section 38 also provides that an institution may be reclassified if the agency deems the institution to be engaged in an unsafe or unsound practice under section 8(b)(8) of the FDI Act. 12 U.S.C. 1818(b)(8). Section 8(b)(8) of the FDI Act was amended by FDICIA to provide that an institution may be deemed to be engaged in an unsafe or unsound practice if the institution has received a less-than-satisfactory rating in its most recent examination report in any of the categories for assets, management, earnings, or liquidity, and the institution has not corrected the deficiency.

Under the proposed rule, an institution would be reclassified on any of these supervisory grounds only after receiving prior written notice of the proposed reclassification from the agency and having an opportunity to respond to the proposed reclassification. In the case of a proposed reclassification based on a determination that the institution is in unsafe or unsound condition, the agencies also propose, pursuant to section 38, to accord the institution an opportunity for an informal oral hearing prior to the reclassification.

Because section 38 expressly provides for notice and opportunity for hearing in connection with a reclassification on the ground of unsafe and unsound condition but does not with respect to the reclassification based on examination ratings, the agencies are not proposing to provide an opportunity for an oral hearing prior to reclassification based on an institution's examination rating. In the case of a reclassification proposed on the basis of an examination rating of the institution, the agencies are proposing to provide the institution an opportunity to present written arguments and information prior to the agency's reclassification of the institution.

Under the proposal, the appropriate federal banking agency would provide an institution with written notice of the agency's intention to reclassify the institution. The institution would be provided at least 14 days to respond to the proposed reclassification unless the agency determines that the condition of the institution warrants a shorter time period for response. In its response, the institution should set forth any reasons why the proposed reclassification would not be appropriate, and provide the agency with any information that the institution believes supports its position on the reclassification. The agency would consider the response in deciding whether to proceed with the reclassification.

Comments 21: The agencies invite comment on all aspects of these procedures for reclassifying institutions based on supervisory criteria other than capital.

G. Timing of Mandatory Provisions

Under section 38, an institution becomes subject to certain mandatory provisions on the basis of the capital levels of the institution. These mandatory provisions apply immediately without agency action. As noted above, an undercapitalized institution is immediately subject to a restriction on the payment of dividends and management fees, a limitation on asset growth, and an obligation to file an acceptable capital restoration plan. In addition to these requirements, an institution that is significantly undercapitalized or critically undercapitalized is subject to a limitation on the payment of bonuses or raises to senior executive officers.

Under the proposal, once an institution is deemed to have notice of its capital levels and category or is given actual notice by the agency of the institution's capital category, the institution is deemed immediately to be subject to the mandatory provisions that apply to institutions within the corresponding capital category without any further action by the appropriate federal banking agency for the institution. As explained above, the agencies propose to deem an institution to have notice of its capital category whenever a Call Report is due to be filed by the institution, or an examination report or report of inspection has been provided to the institution. The agencies will provide actual notice to the institution of its capital categorization if the category is based on an adjustment to capital between the filing of Call Reports or examinations; if the agency determines the capital levels of the institution based on information other than information contained in the Call Reports or an examination report; or if the agency determines to reclassify the institution based on supervisory criteria other than capital.

H. Procedures for Issuing Prompt Corrective Action Directives

Section 38 also provides the agencies with discretion to impose other requirements or restrictions on an insured institution that is undercapitalized, significantly undercapitalized or critically undercapitalized, as well as on any company that controls such an institution. These discretionary supervisory actions are described above.

Because these provisions rely on an agency determination that certain action is appropriate, the agencies are proposing a procedure under which a federal banking agency would issue a written directive whenever the agency has determined that a discretionary supervisory action is appropriate. The agencies propose to provide written notice to an institution prior to issuing any directive to take an action committed by section 38 to the agency's discretion. The notice would describe the action contemplated by the agency and would provide the institution or company with 14 calendar days to respond to the proposed agency action, unless the agency determines that a

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shorter response period is appropriate in light of the condition of the institution.

Under the proposal, the institution or company would be permitted to submit written arguments regarding whether the directive is an appropriate exercise of the agency's discretion, along with any information or evidence supporting the respondent's position, Failure to file a timely response would constitute consent to the issuance of the directive and a waiver of the opportunity to appeal. The agency would consider the institution's response prior to issuing a final directive to take action under section 38.

The agencies are also proposing to permit the appropriate federal banking agency to issue a final directive without notice or opportunity to respond where immediate supervisory action is appropriate. In cases where immediate action is necessary, the agencies propose to provide the institution with an opportunity to appeal the action to the agency and request modification or rescission of the agency action following issuance of the directive. An institution that seeks to appeal an immediately effective directive would be required to file a written appeal with the agency within 14 calendar days of the effective date of the directive. The agency would be required to consider and take action regarding a timely appeal within 60 days of receiving the appeal.

The agencies believe that these procedures will afford an adequate and fair opportunity to obtain agency review of the agency's action. *See, e.q., FDIC* v. *Mallen*, 486 U.S. 230 (1988) (upholding post-deprivation hearing in case of suspension or removal of a bank officer charged with a felony); *Federal Deposit Ins. Corp.* v. *Bank of Coushatta*, 930 F.2d 1122 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 170 (1992) (affirming procedures for issuance of capital directives).

In proposing these procedures, the agencies have attempted to adhere to the mandate of section 38 that the agencies take prompt corrective action to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund while providing institutions with an opportunity for agency review of disputed factual claims. These procedures generally permit an institution advance notice of a proposed directive and an opportunity to present written information and argument to the agency prior to final agency action regarding the directive.

The agencies would not be required to follow these procedures, and the respective time periods would not apply. if an institution consented to the action to be taken by the agency either as initially proposed by the agencies or as modified by mutual agreement. Actions taken with such consent would have the same legal affect and be enforceable to the same extent and by the same means as actions taken upon exhaustion of these procedures.

The agencies are not proposing an oral hearing in connection with the issuance of a prompt corrective action directive for several reasons. First, the terms and legislative history of section 38 indicate that Congress intended agency action under section 38 to be taken as promptly as possible. 12 U.S.C. 1831o(a)(2); see also S. Rep. No. 102–167, 102d Cong., 1st Sess. 32–38 (1991) ("The prompt corrective action system will require regulators to act at the first sign of trouble."). Second, Congress clearly indicated several occasions when it believed that a hearing was appropriate in connection with actions taken under section 38, such as orders requiring dismissal of a director or senior executive officer. Congress gave no indication in either the statutory language or legislative history that it intended to provide for an agency hearing in connection with supervisory actions committed to agency discretion under section 38. Third, a requirement that an agency hold a hearing in each case involving action committed to agency discretion under section 38 would cause the prompt corrective action provisions of section 38 largely to duplicate the existing cease-and-desist authority grant to the agencies under section 8(b) of the FDI Act.

Comment 22: The agencies request comment on all aspects of the proposal to issue prompt corrective action directives where the agency determines to apply the provisions of section 38 committed to the discretion of the agency.

Comment 23: In particular, the agencies request comment on the sufficiency of the proposal to provide notice and opportunity for written response in connection with these directives.

Comment 24: The agencies also request comment on ways that these procedures can be improved to give an institution or company that is subject to a prompt corrective action directive a fair opportunity to contest such a directive, while at the same time adhering to the statutory mandate to take prompt action to resolve the problems of inadequately capitalized institutions.

I. Enforcement of Directives

Section 8 of the FDI Act, as amended by FDICIA, includes prompt corrective action directives issued pursuant to section 38 among the orders that may be enforced in the courts pursuant to section 8(i)(1), and also makes any depository institution, company, or institution-affiliated party that violates such a directive subject to civil money penalties pursuant to section 8(i)(2)(A). 12 U.S.C. 1818(i). The proposed regulation makes clear that failure of a depository institution to implement a capital restoration plan or the failure of a company having control of a depository institution to fulfill a guarantee that the company has given in connection with a capital plan accepted by the appropriate federal banking agency will subject responsible parties to civil money penalties.

J. Dismissal of Directors or Senior Executive Officers

Section 38 provides that a director or senior executive officer dismissed by an insured depository institution in compliance with an agency directive under section 38 may obtain review of the dismissal by filing with the appropriate federal banking agency a petition of reinstatement. The statute also provides that the petitioner shall have the opportunity to submit written materials in support of the petition and to appear at a hearing before member(s) or designated employee(s) of the agency. The hearing shall occur within 30 days of the filing of the petition unless the petitioner requests a later date. The agency decision shall issue within 60 days of the date of the closing of the hearing record.

The statute appears to envision on a post-dismissal hearing procedure, as it refers to the appeal as a "petition for reinstatement" and sets a short time for agency decision. Accordingly, the proposed regulation contemplates that an institution ordered to dismiss a senior executive officer or director will take that action immediately upon receiving a final directive requiring that action. The agencies are proposing that any officer or director that is dismissed in compliance with an agency directive under section 38 be provided an opportunity to petition the appropriate federal banking agency for reinstatement within the statutorily-prescribed period.

The proposed regulation permits the affected officer or director an opportunity for an informal agency hearing. The agency will designate a presiding officer(s) to conduct the hearing. The petitioner will have the right to appear at the hearing, with counsel, and to submit written materials and present oral argument. The petitioner may present oral testimony or

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witnesses only with the consent of the presiding officer(s).

The proposed regulation incorporates the statutory burdens of proof imposed upon an officer or director seeking reinstatement. When the dismissal order is based upon an institution's capital category or its failure to submit or implement a capital restoration plan, the petitioner must prove that his or her continued employment would materially strengthen the institution's ability to become adequately capitalized. When the dismissal order is based upon a reclassification of an institution on grounds of unsafe or unsound condition or practice, the petitioner must prove that his or her continued employment would materially strengthen the institutions' ability to correct the condition or practice. The agencies propose to restrict the ability of an officer or director seeking reinstatement to challenge the capital category to which the institution has been assigned.

Comment 25: The agencies seek comment on these procedures.

K. Capital Restoration Plans

1. Information Required

Section 38 requires an institution that is under-capitalized, significantly under capitalized, or critically undercapitalized to submit a plan to the appropriate federal banking agency to restore the institution's capital at least to the minimum capital levels required for adequately capitalized institutions. The statute requires that this capital restoration plan be submitted in writing and specify:

(1) The steps the institution will take to become adequately capitalized;

(2) The levels of capital the institution expects to attain in each year that the plan is in effect;

(3) How the institution will comply with the restrictions and requirements imposed on the institution under section 38;

(4) The types and levels of activities in which the institution will engage; and

(5) Any other information required by the appropriate federal banking agency.

The agencies do not propose at this time to require by regulation any additional information in a capital restoration plan submitted under section 38. The agencies may, in individual cases, require an institution to provide additional information based on particular circumstances.

Comment 26: The agencies request comment on whether and what additional information should be required by regulation for all capital restoration plans submitted under section 38.

2. Schedule for Submission and Review of Capital Plans

The statute requires the agencies to establish by regulation deadlines for the submission and review of capital restoration plans. The agencies propose to adopt the schedule generally established in the statute. Under this schedule, an institution would generally be required to submit a capital restoration plan within 45 days of receiving notice or having been deemed to have notice that the institution is undercapitalized, significantly undercapitalized or critically undercapitalized. As discussed above, an institution is deemed to have been notified of its capital category on the date that it is required to file its Call Report, the date that the institution receives its final report of examination or inspection, or the date that the appropriate federal banking agency notifies the institution of the institution's capital category (based on an adjustment to capital reported by the institution or on other information obtained by the agency). Under the proposal, the appropriate federal banking agency may change this period in individual cases, in which case the agency would notify the institution that a different schedule has been adopted.

The proposed schedule would require the appropriate federal banking agency to review each capital restoration plan within 60 days of submission of the plan unless the agency extends the time for review. The agencies propose to provide written notice to the institution regarding whether the agency has approved or rejected the capital plan. The agency would also provide a copy of each acceptable capital restoration plan, or amendments thereto, to the FDIC within 45 days of accepting the plan.

Comment 27: The agencies request comment on the proposed time schedules for submission and review of a capital restoration plan.

3. Failure to Submit or Implement an Acceptable Capital Plan

In the event that the appropriate federal banking agency has disapproved an institution's capital restoration plan, the proposal would require the institution to submit a new capital restoration plan within a time specified by the appropriate federal banking agency. During the period following notice of such disapproval and prior to approval by the agency of a new or revised capital plan, the institution would be subject to all of the provisions in section 38 that apply to undercapitalized institutions that have failed to submit and implement, in any material respect, an acceptable capital restoration plan.

The proposed regulation incorporates the provision of section 38 that makes any insured depository institution that is undercapitalized and fails to submit or implement a capital restoration plan within the required time subject to the provisions applicable to significantly undercapitalized institutions. Under the proposal, these provisions apply immediately upon expiration of the time for submission of a capital restoration plan. Accordingly, under the proposal, an undercapitalized institution that fails to submit a capital restoration plan within the required time would, upon the expiration of that period, become subject to the mandatory and discretionary provisions of section 38 outlined above that are applicable to significantly undercapitalized institutions, including limitations on the compensation paid to senior executive officers. An undercapitalized institution that fails to implement, in any material respect, its capital restoration plan would immediately be subject to these same provisions upon the institution's failure to implement the plan.

Comment 28: The agencies invite comment on each of these aspects of the proposed rule.

4. Content of Capital Restoration Plans

Section 38 provides that the appropriate federal banking agency may not accept a capital restoration plan unless the plan:

(1) Contains the information required by statute;

(2) Is based on realistic assumptions and is likely to succeed in restoring the institution's capital; and

(3) Would not appreciably increase the risk (including credit risk, interest-rate risk, and other types of risk) to which the institution is exposed.

The statute also provides that the appropriate federal banking agency may not approve a capital restoration plan unless each company that controls the institution guarantees the institution's compliance with the plan until the institution has been adequately capitalized for each of four consecutive calendar quarters, and provides appropriate assurances of performance. This guarantee by any controlling company is independent of any liability of affiliates of the depository institution pursuant to the cross-guarantee provision of the FDI Act.

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5. Capital Plan Performance Guarantee

The agencies propose to implement the performance guarantee provision, contained in section 38(e)(2)(E), by requiring each company to submit a written guarantee of any capital plan submitted by an undercapitalized, significantly undercapitalized, or critically undercapitalized institution controlled by the company. This guarantee would include assurance that the institution would fulfill any commitments to raise capital made in the plan. Each company that provides the guarantee would be jointly and severally liable for fulfillment of the guarantee. Liability could extend to the amount necessary (up to the statutory limit of liability) to restore the institution to applicable capital standards. Failure of any company that controls an undercapitalized institution to provide the required guarantee causes the institution to become subject to the provisions of section 38 applicable to significantly undercapitalized institutions.

Comment 29: The agencies request comment on whether the rule should provide greater detail regarding the content and form of the guarantee.

Comment 30: In addition, the agencies request comment on what assurances the agencies should find to be "appropriate assurances of performance" of the capital plan and guarantee. Section 38 appears to permit the agencies to determine the appropriateness of assurances in connection with the agency's review of the capital restoration plan.

Comment 31: The agencies seek comment on whether there are particular assurances that the agencies should require by regulation in all cases. For example, should the agencies require a guarantor to demonstrate that it has sufficient financial resources to honor the guarantee?

The statute limits the aggregate liability under the capital performance guarantee of all companies that control a given insured depository institution to the lesser of:

(1) An amount equal to 5 percent of the institution's total assets at the time the institution became undercapitalized; or

(2) The amount necessary (or that would be necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time the institution fails to comply with its capital restoration plan.

In incorporating this provision into the regulation, the agencies propose to adopt the same definition of total assets for purposes of computing the first component of the limit on liability as would be used in determining the capital category of the institution.

Comment 32: Accordingly, as discussed above in connection with the definition of capital categories, the agencies request comment on whether the definition of total assets should be based on a period average of total assets (as proposed above) or should be based on a daily report of the institution's total assets.

The agencies also propose that the second component of the limit on liability refers to the amount necessary to restore the capital of the institution to the applicable minimum capital levels as those levels were defined at the time that the institution initially failed to comply with its capital plan. The amount of a capital guarantee would not change if the minimum capital adequacy requirements change after the time the institution initially failed to comply with its capital restoration plan.

Comment 33: The agencies request comment on this clarification of the statutory provision.

The proposed rule also implements the statutory provision that limits the duration of a guarantee of a capital plan. Under the proposal, the appropriate federal banking agency would provide notice to the company that the guarantee has expired once the depository institution has remained adequately capitalized for four consecutive calendar quarters. The proposal makes clear that expiration of a guarantee or fulfillment of a guarantee given by a company in connection with one capital restoration plan does not relieve the company from the obligation to guarantee another capital restoration plan that may be required at a future date for the same institution if it again becomes undercapitalized. Similarly, the fact that a company has, at one time, fulfilled a guarantee by providing resources to an institution up to the statutory limit would not reduce the amount of any guarantee of a future capital plan for the same institution. Moreover, the provision or fulfillment by a company of a guarantee for one institution does not affect the obligation of that company to guarantee a capital plan in connection with any other insured depository institution.

Comment 34: The agencies request comment on these provisions of the proposal.

Comment 35: The agencies also request comment on whether the agencies should establish by regulation a time for computing the limit on liability, and, if so, when that calculation should be made.

Comment 36: In addition, the agencies request comment on whether any additional regulatory clarifications of the holding company guarantee are necessary.

6. Priority in Bankruptcy

It should be noted that the FDIC will have a priority claim in any bankruptcy proceedings of a holding company that has guaranteed an institution's compliance with a capital restoration plan. The FDIC's claim against a holding company's estate would have priority over the claims of unsecured creditors and is provided for in section 507(a)(8) of title 11 of the United States Code, as amended by the Crime Control Act of 1990, Public Law 101–647, 104 Stat. 4789. Sections 365(o) and 523(a)(12) of title 11 of the United States Code, as amended by the Crime Control Act of 1990, also provide special protections for the FDIC.

7. Submission of Plans by Reclassified Institutions

Section 38(g) provides that an institution that has been reclassified to a different capital category as a result of an agency determination that the institution is in an unsafe or unsound condition or is engaged in an unsafe or unsound practice must describe the steps the institution will take to address these deficiencies. Section 38(g) also provides that an institution that nominally has adequate capital but has been reclassified to the under-capitalized category because of its condition or practices is not required to submit a capital restoration plan. The portions of the proposed regulation regarding capital restoration plans reflect these provisions.

Comment 37: While section 38 does not require an institution that nominally has adequate capital but has been reclassified to the undercapitalized category to file a capital restoration plan, the agencies request comment regarding whether it is appropriate for the agencies to exercise their general supervisory authority to require such an institution to submit a description of the steps the institution will take to address the deficiencies in the institution's condition.

8. Revised Capital Restoration Plans

Under the proposal, and insured depository institution that is operating under a capital restoration plan that has been approved by the appropriate federal banking agency would not generally be required to submit an additional or a revised capital restoration plan if the institution's

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capital classification changes, unless the agency notifies the institution that a new or revised capital restoration plan is required. Under this proposal, for example, an undercapitalized institution that is implementing an approved capital restoration plan would not be required to submit a second or revised capital restoration plan if the institution experienced further declines in its capital levels unless the appropriate federal banking agency determined that a new plan was appropriate in light of the particular circumstances.

Comment 38: The agencies request comment on this approach and on whether the agencies should, by regulation, require each insured depository institution to file a new or revised capital restoration plan in the event that the institution's capital category has changed.

L. Other Matters

1. Definition of "Management Fee"

Section 38 of the FDI Act prohibits any institution from paying management fees to a controlling person if, following the payment of those fees, the institution would be undercapitalized. The statute does not provide a definition of management fees. The agencies have proposed to define management fees to include any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice other than compensation paid to an individual in the individual's capacity as an officer or employee of the institution. This definition covers all companies, including consulting firms, companies owned by the principal shareholder of an institution, and servicing corporations owned by bank holding companies. Under the proposal, compensation for duties performed by an officer or employee of the institution would not be deemed to be a management fee for purposes of section 38.

Comment 39: The agencies request comment on the proposal's provisions regarding management fees and compensation in light of the purpose of section 38 of limiting losses to the deposit insurance funds that might result from the payment of dividends or the payment of management fees by an undercapitalized institution or an institution that would be undercapitalized after the payment.

2. Definition of "Control"

Certain provisions of section 38 apply to companies that "control" an insured depository institution. Section 38 of the FDI Act does not define the term "control". However, section 3 of the FDI Act adopts the definition of "control" contained in section 2 of the Bank Holding Company Act ("BHC Act") (12 U.S.C. 1841(a)(2)). Under the BHC Act, a company controls an institution if (1) the company owns or controls 25 percent or more of any class of voting securities of that institution; (2) the company controls in any manner the election of a majority of the board of directors of the institution; or (3) the agency determines, after notice and opportunity for hearing, that the company exercises a controlling influence over the management or policies of the institution.

Other provisions of the BHC Act exclude certain types of share ownership from the provisions of the BHC Act, including shares acquired by a company in satisfaction of a debt previously contracted ("DPC") or shares held by a company in a fiduciary capacity.

Comment 40: The agencies request comment on whether it would be appropriate under section 38 to provide, by regulation, an exception from the definition of "control" for shares acquired DPC or shares held in a fiduciary capacity.

Comment 41: In particular, the agencies request comment on whether the agencies should by regulation adopt the DPC and fiduciary ownership exceptions contained in section 2(a)(5) of the Bank Holding Company Act. Section 2(a)(5) of the BHC Act (12 U.S.C. 1841(a)(5)) permits a company to hold shares of a depository institution acquired DPC without becoming subject to the restrictions of that Act provided that the company disposes of the shares within two years (with the possibility of three one-year extensions). Section 2(a)(5) also permits a company to hold shares of a depository institution in a fiduciary capacity without becoming subject to the restrictions of the BHC Act provided that the company does not retain sole right to vote the shares.

Comment 42: Finally, in the event that an exception for shares acquired DPC is included in the regulations implementing section 38, the agencies request comment on whether the exception should include conditions similar to those contained in the DPC exception to section 5 of the FDI Act (12 U.S.C. 1815(e)), which imposes cross-guarantee requirements on affiliated institutions. Section 5 of the FDI Act contains an exception for the acquisition by an insured depository institution of shares of another depository institution in satisfaction of a debt previously contracted. That exception is conditioned on the requirement that all transactions between the controlling institution or any affiliate of the controlling institution and the subsidiary institution comply with the restrictions contained in sections 23A and 23B of the Federal Reserve Act.

3. Applicability of Capital Categories to Bank Holding Companies and Savings and Loan Holding Companies

Section 38 applies capital-based prompt corrective action to insured depository institutions but not to holding companies that control such institutions. However, various provisions of section 38 apply to companies that control insured depository institutions. These provisions appear to apply to holding companies regardless of the capital level of those holding companies.

The Federal Reserve Board and the OTS do not propose to adopt a parallel framework of capital categories for holding companies. Instead, the Federal Reserve intends to consult with the federal banking agency for each insured depository institution subsidiary of the holding company to monitor supervisory actions required under section 38, and, in the supervision of the holding company, to take appropriate action at the holding company level based on an assessment of these developments. In supervising savings and loan holding companies, the OTS will also take appropriate action at the holding company level based on an assessment of the actions taken under section 38 regarding its savings association subsidiaries.

Comment 43: The agencies request comment on whether it is appropriate for the agencies to exercise their supervisory authority under other provisions of law to establish a framework of supervisory actions for bank holding companies and savings and loan holding companies similar to those established in section 38 for insured depository institutions.

4. Restrictions on Activities of Critically Undercapitalized Institutions

Section 38(i) of the FDI Act provides that the FDIC must, by regulation or order, restrict the activities of critically undercapitalized institutions. The activities that must be restricted are described above. In order to facilitate state member banks providing comments on the FDIC's proposal to implement the restrictions on section 38(i), the following discussion of the FDIC proposal has been provided.

The FDIC proposes to rely on existing industry or regulatory guidance, to the extent possible, when evaluating and applying each of the restrictive provisions of section 38(i) and to

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continue to coordinate closely with the primary Federal and/or State banking regulators. The interagency procedures implemented will be similar to those already in place at both the Federal agency and state banking department levels. For example, prior to imposing any order restricting or prohibiting an institution from engaging in any of the activities that can be restricted, the FDIC would consult with the appropriate federal banking agency and State banking agency, as appropriate.

FDICIA does not provide specific guidance on how to interpret and implement each of the above restrictive provisions. Consequently, the FDIC is considering a number of options.

The prohibition on entering into "any material transaction other than in the usual course of business" can be interpreted in a general fashion relying on outstanding case law in the area of securities disclosures. The concept of materiality also could be defined from an accounting perspective by establishing specific limits for determining materiality. For example, the FDIC could, by regulation, require that any prospective transaction other than one that is in the usual course of business that results or could result in a 5 percent change in an institution's tangible equity capital account or net income account would automatically be considered a material transaction requiring the FDIC's prior approval. Other transactions could be defined as material on a case by case basis.

Comment 44: The FDIC solicits comment on how to define the terms "material" and "usual course of business" as well as what specific guidance, if any, should be provided by the FDIC to the banking industry.

The FDIC proposes to define the term "highly leveraged transaction" by utilizing the currently outstanding interagency definition published in the **Federal Register** (57 FR 5040, February 11, 1992). The FDIC proposes to rely on existing generally accepted accounting principles when interpreting the restriction on making any "material change in accounting method."

Section 39(c) of the FDI Act requires the federal banking agencies to prescribe standards for determining when compensation paid to employees, directors and principal shareholders of insured depository institutions is excessive. An advance notice of proposed rulemaking is expected to be published in the **Federal Register** in the near future. The FDIC intends to interpret the restrictive provision of section 38(i) involving the payment of excessive compensation or bonuses in a manner that is consistent with the FDIC's actions in fulfilling the requirements of section 39(c) of the FDI Act.

The provision that restricts "paying interest on new or renewed liabilities at a rate that would increase the institution's weighted average cost of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in the institution's normal market areas" contains terms that relate to the changes mandated by section 301 of FDICIA and the revisions of § 337.6 of the FDIC's regulations as recently implemented by the FDIC. The FDIC proposes to interpret the phrase "significantly exceeding the prevailing rates" the same as defined in § 337.6. The prevailing effective yields of interest are the effective yields on insured deposits of comparable maturities offered by other insured depository institutions in the market area in which deposits are being solicited. A rate of interest on a deposit with an odd maturity will be considered excessive if it is more than 75 basis points higher than the yield calculated by interpolating between the yields offered by other depository institutions on deposits of the next longer and shorter maturities offered in the market. A market area is any readily defined geographic area in which the rates offered by any one insured depository institution operating in the area may affect the raters offered by other institution operating in the same area.

The FDIC invites comments on all aspects of these proposed interpretations.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires an initial regulatory flexibility analysis with any notice of proposed rulemaking. A description of the reasons why the action by the Board is being considered and a statement of the objectives of, and legal basis for, the proposed rule are contained in the supplementary information above. There are no relevant federal rules that duplicate, overlap, or conflict with the proposed rule.

The proposed rule implements the prompt corrective action provisions of section 131 of FDICIA for all state member banks, regardless of size. The regulation requires each bank to monitor its capital levels and to report to the Board any event that would change the bank's capital category. The proposed rule requires that a bank that becomes undercapitalized, significantly undercapitalized, or critically undercapitalized submit a capital restoration plan.

The proposal is not expected to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act. The filing of the capital plan is a requirement imposed by statute and occurs only when an institution initially becomes undercapitalized, significantly undercapitalized, or critically undercapitalized. In establishing a mechanism for gathering sufficient information to determine the appropriate capital category for each state member bank, the Board has attempted to reduce the burden imposed on such banks by relying primarily on the call report that must already be filed and on reports of examination that would otherwise take place. No additional regular reporting requirement has been proposed. Rather, each state member bank is required to monitor its capital levels—an effort that analysts at an institution should already be undertaking—and report to the Board only when an event occurs that would change the capital category in which the banks was previously placed.

Paperwork Reduction

The proposal would require certain state member banks to file capital restoration plans and would require all banks to monitor their capital levels and report any event that would result in a change in capital category under prompt corrective action. As described above, the filing of a capital plan occurs only under limited circumstances and is required by statute. The requirement that a state member bank notify the Board of an event that would change its capital category is intended to supplement existing call report data and reports of examination, and should be triggered infrequently. The institution should not be required to engage in significant additional recordkeeping to comply with this requirement.

List of Subjects

12 CFR Part 208

Accounting, Agriculture, Banks, Banking, Confidential business information, Currency, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

12 CFR Part 263

Administrative practice and procedure, Federal Reserve System.

For the reasons outlined above, the Board of Governors proposes to amend 12 CFR parts 208 and 263 as set forth below:

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PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for 12 CFR part 208 is revised to read as follows:

Authority: Secs. 9, 11(a), 11(c), 19, 21, 25 and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321–338, 248(a), 248(c), 461, 481–486, 601, and 611, respectively); secs. 4, 13(j) and 38 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814, 1823(j), and 1831o, respectively); sec. 7(a) of the International Banking Act of 1978 (12 U.S.C. 3105); secs. 907–910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3906–3909); secs. 2, 12(b), 12(g), 12(i), 15B(c)(5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 781(b), 1781(g), 781(i), 78o–4(c)(5), 78q, 78q–1, and 78w, respectively); sec. 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadded Act of 1927; and secs. 1101–1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331–3351).

2. The undesignated centerheading preceding § 208.1 is removed, §§ 208.1 through 208.19 are designated as subpart A to part 208, and the subpart A heading is added to read as follows:

Subpart A—General Provisions

3. Subpart B, comprising §§ 208.30 through 208.35, is added to part 208 to read as follows:

Subpart B—Prompt Regulatory Action

Sec.
208.30 Authority, purpose, applicability and other supervisory authority.
208.31 Definitions.
208.32 Financial data calculations and notice of capital category.
208.33 Capital measures and capital category definitions.
208.34 Capital restoration plans.
208.35 Mandatory and discretionary supervisory actions and section 38.

Subpart B—Prompt Regulatory Action

§ 208.30 Authority, purpose, applicability and other supervisory authority.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (Board) pursuant to section 38 (section 38) of the Federal Deposit Insurance Act (FDI Act), as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose.* Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this subpart is to define, for state member banks, the capital measures and capital levels that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of orders pursuant to that section.

(c) *Applicability.* This subpart implements the provisions of section 38 of the FDI Act as they apply to state member banks. Certain of these provisions also apply to officers, directors and employees of state member banks. Other provisions apply to any company that controls a state member bank and to the affiliates of a state member bank.

(d) *Other Supervisory Authority.* Neither section 38 nor this subpart in any way limits the authority of the Board under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law or regulation, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the Board, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) *Limited Scope of Capital Categories.* The assignment of a bank under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38 and, unless permitted by the Board or otherwise required by law or regulation, may not be used by, for, or on behalf of a state member bank for any other purpose.

§ 208.31 Definitions.

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used in this subpart have the same meanings as set forth in sections 38 and 3 of the FDI Act.

(a) *Leverage ratio* means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure (appendix B to part 208).

(b) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(c) *Risk-weighted assets* means total weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208).

(d) *Tangible equity* means the amount of Tier 1 capital as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208).

(e) *Tier 1 capital* means the amount of Tier 1 capital as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208).

(f) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208).

(g) *Total assets* means average total consolidated assets as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure (appendix B to part 208).

(h) *Total risk-based capital ratio* means the ratio of qualifying total capital to risk-weighted assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to part 208).

§ 208.32 Financial data calculations and notice of capital category.

(a) *Effective date of determination of capital category.* A state member bank shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) *Notice of capital category.* A state member bank shall be deemed to have notice of its capital levels and its capital category as of the most recent of:

(1) The date of Report of Condition and Income ("Call Report") is required to be filed with the Board;

(2) The date a final report of examination or report of inspection is delivered to the bank;

(3) The date that the Board provides written notice to the bank that the bank's capital category has changed as provided in paragraph (C) of this section;

(4) The date that the Board provides written notice to the bank of its capital levels and its capital category for

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purposes of section 38 of the FDI Act and this subpart; or

(5) The date any written notice is served in the bank that the bank's capital category has been changed pursuant to § 208.33(c).

(c) Adjustments of reported capital levels and category—(1) *Notice of adjustment to be provided by bank.* A state member bank shall provide the Board with written notice that an adjustment to the bank's capital category may have occurred no later than 5 calendar days following the earlier of the date that the bank:

(i) Reports, or has determined to report, any event that would cause the bank to be placed in a different capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent Call Report or report of examination or inspection; or

(ii) Determines that any event has occurred that would cause the bank to be placed in a different capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent Call Report or report of examination or inspection.

(2) *Determination to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the Board shall determine whether the capital category of the bank should be changed and shall notify the bank of the Board's determination.

§ 208.33 Capital measures and capital category definitions.

(a) *Capital measures.* For purposes of section 38 and this subpart, the relevant capital measures shall be:

(1) The total risk-based capital ratio;

(2) The Tier 1 risk-based capital ratio; and

(3) The leverage ratio.

(b) *Capital categories.* For purposes of the provisions of section 38 and this subpart, a state member bank shall be deemed to be:

(1) "Well capitalized" if the bank:

(i) Has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Has a leverage ratio of 5.0 percent or greater; and

(iv) Is not subject to any order of final capital directive by the Board to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if the bank:

(i) Has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Has a Tier 1 risk-based capital ratio of 4.0 percent or greater;

(iii) Has—

(A) A leverage ratio of 4.0 percent or greater, or

(B) A leverage ration of 3.0 percent or greater if the bank is rated composite 1 under the CAMEL rating system in the most recent examination or inspection of the bank and is not experiencing or anticipating significant growth; and

(iv) Does not meet the definition of a "well capitalized" bank.

(3) "undercapitalized" if the bank—

(i) Has a total risk-based capital ratio that is less than 8.0 percent; or

(ii) Has a Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(iii) (A) Except as provided in clause (B), has a leverage ratio that is less than 4.0 percent; or

(B) If the bank is rated composite 1 under the CAMEL rating system in the most recent examination or inspection of the bank, has a leverage ratio that is less than 3.0 percent.

(4) "Significantly undercapitalized" if the bank has—

(i) A total risk-based capital ratio that is less than 6.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 3.0 percent; or

(iii) A leverage ratio that is less than 3.0 percent.

(5) "Critically undercapitalized" if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Classification based on supervisory criteria other than capital.* The Board may reclassify a well capitalized state member bank as adequately capitalized and may require an adequately capitalized or an undercapitalized state member bank to comply with supervisory actions as if it were in the next lower capital category (except that the Board may not reclassify a significantly undercapitalized bank as critically undercapitalized) in the following circumstances:

(1) *Unsafe or unsound conditions.* The Board has determined, after notice and opportunity for hearing pursuant to § 263.202(a) of this chapter, that the bank is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The Board has determined, after notice and opportunity for response pursuant to § 263.202(b) of this chapter, that the bank has received, and not corrected, a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity in the most recent examination or inspection of the bank.

§ 208.34 Capital restoration plans.

(a) *Schedule of filing plan—(1) In general.* A state member bank must file a written capital restoration plan with the appropriate Reserve Bank within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the Board notifies the bank in writing that the plan must be filed within a different period. A bank that has been reclassified as undercapitalized pursuant to § 208.33(c) is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures unless the Board notifies the bank that it must submit a new or revised capital plan. A bank that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate Reserve bank within 45 days of receiving such notice, unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the Board instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act, including any performance guarantee required to be executed under section 38(e)(2)(C) of that Act by each company that controls the bank. A bank that is required to submit a capital restoration plan as the result of a reclassification of the bank pursuant to § 208.33(c) shall include a description of the steps the bank will take to correct the unsafe or unsound condition or practice.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the Board will provide written notice to the bank of whether the plan has been approved. The Board may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If a capital restoration plan is not approved by the Board, the bank must submit a revised capital restoration plan within the time specified by the Board. Upon

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receiving notice that its capital restoration plan has not been approved, any undercapitalized state member bank (as defined in § 208.33(b)(3)) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the bank has been approved by the Board.

(e) *Failure to submit a capital restoration plan.* A state member bank that is undercapitalized (as defined in § 208.33(b)(3)) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement a capital restoration plan.* Any undercapitalized state member bank that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital plan.* A bank that has filed an approved capital restoration plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* With 45 days of the effective date of Board approval of a capital restoration plan, or any amendment to a capital restoration plan, the Board will provide a copy of such plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank.*—(1) *Limitation on liability.*—(i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific state member bank that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank's total assets at the time the bank was notified or deemed to have notice that the bank was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank to the levels required for the bank to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the Board notifies the bank that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a given bank shall be jointly and severally liable for the guarantee for such bank as required under section 38 and this subpart, and the Board may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank that is controlled by any company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks that have not submitted an approved capital restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a bank to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank shall be subject to the provisions of section 38 and this subpart that are applicable to banks that have failed in a material respect to implement a capital restoration plan.

§ 208.35 Mandatory and discretionary supervisory actions under section 38.

(a) *Mandatory supervisory actions.*—(1) *Provisions applicable to all banks.* All state member banks are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks.* Immediately upon receiving notice or being deemed to have notice, as provided in § 208.32 or § 208.34 of this subpart, that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act—

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the Board monitor the condition of the bank (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the bank's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.32 or § 208.34 of this subpart, that the bank is significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a) (2) and (3) of this section, immediately upon receiving notice of being deemed to have notice, as provided in § 208.32 or § 208.34 of this subpart, that the bank is critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act—

(i) Restricting the activities of the bank (section 38(h)(1)); and

(ii) Restricting payments on subordinated debt of the bank (section 38(h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the Board's discretion to take in connection with a state member bank that is deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, an officer or director of such bank, or a company that controls such bank, the Board will follow the procedures for issuing directives under §§ 263.201 and 263.203 of this chapter, unless otherwise provided in section 38 or this subpart.

4. Subparts C and D are added to part 208 and reserved, the undesignated centerhead preceding § 208.116 is removed, §§ 208.116, 208.117, 208.122, and 208.124 through 208.128 are

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designated as subpart E of part 208, and the subpart E heading is added to read as follows:

Subpart E—Interpretations

PART 263—RULES OF PRACTICE FOR HEARINGS

1. The authority citation for 12 CFR part 263 is revised to read as follows:

Authority: 5 U.S.C. 504; 12 U.S.C. 248, 324, 504, 505, 1817(j), 1818, 1828(c), 1831o, 1847(b), 1847(d), 1884(b), 1972(2)(F), 3105, 3107, 3108, 3907, 3909, 15 U.S.C. 21, 78o–4, 78o–5, and 78u–2.

2. Section 263.50(b) is amended by removing the word "and" at the end of paragraph (b)(9), removing the period at the end of paragraph (b)(10) and adding in its place a semicolon, and by adding paragraphs (b)(11) through (b)(14) to read as follows:

§ 263.50 Purpose and scope.

* * * * *

(b) * * *

(11) Issuance of a prompt corrective action directive to a member bank under section 38 of the FDI Act (12 U.S.C. 1831o);

(12) Reclassification of a member bank on grounds of unsafe or unsound condition under section 38(g)(1) of the FDI Act (12 U.S.C. 1831o(g)(1));

(13) Reclassification of a member bank on grounds of unsafe and unsound practice under section 38(g)(1) of the FDI Act (12 U.S.C. 1831o(g)91)); and

(14) Issuance of an order requiring a member bank to dismiss a director or senior executive officer under section 38(e)(5) and 38(f)(2)(F)(ii) of the FDI Act (12 U.S.C. 1831o(e)(5) and 1831o(f)(2)(F)(ii)).

3. A new subpart H is added to part 263 to read as follows:

Subpart H—Issuance and Review of Orders Pursuant to Prompt Regulatory Action

Sec.

§ 263.200 Scope.
§ 263.201 Directives to take prompt regulatory action
§ 263.202 Procedures for reclassifying a state member bank based on criteria other than capital.
§ 263.203 Order to dismiss a director or senior executive officer.
§ 263.204 Enforcement of directives.

SUBPART H—INSURANCE AND REVIEW OF ORDERS PURSUANT TO PROMPT REGULATORY ACTION

§ 263.200 Scope.

(a) The rules and procedures set forth in this subpart apply to state member banks, companies that control state member banks or are affiliated with such banks, and senior executive officers and directors of state member banks that are subject to the provisions of section 38 of the Federal Deposit Insurance Act (section 38) and subpart B of part 208 of this chapter.

§ 263.201 Directives to take prompt regulatory action.

(a) *Notice of intent to issue a directive.*—(1) *In General.* The Board will provide an undercapitalized, significantly undercapitalized, or critically undercapitalized state member bank or, where appropriate, any company that controls the bank, prior written notice of the Board's intention to issue a directive requiring such bank or company to take actions or to follow proscriptions described in section 38 that are within the Board's discretion to require or impose under section 38(e)(5), (f)(2), (f)(3), or (f)(5) of the FDI Act.

(2) *Immediate issuance of final directive.* If the propose Board finds it necessary in order to carry out the purposes of section 38 of the FDI Act, the Board may, without providing the notice prescribed in paragraph (a)(1) of this section, issue a directive requiring a state member bank or any company that controls a state member bank immediately to take actions or to follow proscriptions described in section 38 that are within the Board's direction to require or impose under section 38(e)(5), (f)(2), (f)(3), or (f)(5) of the FDI Act. A bank or company that is subject to such an immediately effective directive may submit a written appeal of the directive of the Board. Such an appeal must be received by the Board within 14 calendar days of the issuance of the directive. The Board shall consider any such appeal, if filed in a timely matter, within 60 days of receiving the appeal. During such period of review, the directive shall remain in effect unless the Board, in its sole discretion, stays the effectiveness of the directive.

(b) *Contents of notice.*—A notice of intention to issue a directive shall include:

(1) A statement of the bank's capital measures and capital levels;

(2) A description of the restrictions, prohibitions or affirmative actions that the Board proposes to impose or require;

(3) The proposed date when such restrictions or prohibitions would be effective or the proposed date for completion of such affirmative actions; and

(4) The date by which the bank or company subject to the directive may file with the Board a written response to the notice.

(c) *Response to notice.*—(1) *Time for Response.* A bank or company may file a written response to a notice of intent to issue a directive within the time period set by the Board. The date shall be at least 14 calendar days from the date of the notice unless the Board determines that a shorter period is appropriate in light of the financial condition of the bank or other relevant circumstances.

(2) *Content of Response.* The response should include:

(i) An explanation why the action proposed by the Board is not an appropriate exercise of discretion under section 38;

(ii) Any recommended modification of the proposed directive; and

(iii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank or company regarding the proposed directive.

(d) *Failure to file agency response.* Failure by a bank or company to file with the Board, within the specified time period, a written response to a proposed directive shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of the directive.

(e) *Board consideration of response.* After considering the response, the Board may:

(1) Issue the directive as proposed or in modified form;

(2) Determine not to issue the directive and so notify the bank or company; or

(3) Seek additional information or clarification of the response from the bank or company, or any other relevant source .

(f) *Request for modification or rescission of directive.* Any bank or company that is subject to a directive under this subpart may, upon a change in circumstances, request in writing that the Board reconsider the terms of the directive, and may propose that the directive be rescinded or modified. Unless otherwise ordered by the Board, the directive shall continue in place while such request is pending before the Board.

§ 263.202 Procedures for reclassifying a state member bank based on criteria other than capital.

(a) *Classification of a state member bank based on unsafe or unsound condition—(1)Issuance of notice of proposed reclassification.* If the Board determines to reclassify a well capitalized state member bank as adequately capitalized or to require an adequately capitalized or undercapitalized state member bank to comply with supervisory actions as if it

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were in the next lower capital category pursuant to section 38(g) of the FDI Act and § 208.33(c)(1) of Regulation H (12 CFR 208.33(c)(1)) because the Board deems the bank to be in unsafe or unsound condition (each of the foregoing referred to hereinafter as a "reclassification"), the Board will issue and serve on the bank a written notice of the Board's intention to reclassify the bank.

(2) *Contents of notice.* A notice of intention to reclassify a bank based on unsafe or unsound condition will include:

(i) A statement of the bank's capital measures and capital levels and the category to which the bank would be reclassified;

(ii) The reasons for reclassification of the bank;

(iii) The date by which the bank subject to the notice of reclassification may file with the Board a written appeal of the proposed reclassification and a request for a hearing, which shall be at least 14 calendar days from the date of service of the notice unless the Board determines that a shorter period is appropriate in light of the financial condition of the bank or other relevant circumstances.

(3) *Response to notice of proposed reclassification.* A bank may file a written response to a notice of proposed reclassification within the time period set by the Board. The response should include:

(i) An explanation of why the bank is not in unsafe or unsound condition or otherwise should not be reclassified;

(ii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank or company regarding the reclassification.

(4) *Failure to file response.* Failure by a bank to file, within the specified time period, a written response with the Board to a notice of proposed reclassification shall constitute a waiver of the opportunity to respond and shall constitute consent to the reclassification.

(5) *Request for hearing and presentation of oral testimony or witnesses.* The response may include a request for an informal hearing before the Board or its designee under this section. If the bank desires to present oral testimony or witnesses at the hearing, the bank must include a request to do so with the request for an informal hearing. A request to present oral testimony or witnesses shall specify the names of the witnesses and the general nature of their expected testimony. Failure to request a hearing shall constitute a waiver of any right to a hearing, and failure to request the opportunity to present oral testimony or witnesses shall constitute a waiver of any right to present oral testimony or witnesses.

(6) *Order for informal hearing.* Upon receipt of a timely written request including a request for a hearing, the Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the bank requests a later date. The hearing shall be held in Washington, DC or at such other place as may be designated by the Board, before a presiding officer(s) designated by the Board to conduct the hearing.

(7) *Hearing procedures.* (i) The bank shall have the right to introduce relevant written materials and to present oral argument at the hearing. The bank may introduce oral testimony and present witnesses only if expressly authorized by the Board or the presiding officer(s). Neither the provisions of the Administrative Procedure Act governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure in subpart A of this part apply to an informal hearing under this section unless the Board orders that such procedures shall apply.

(ii) The informal hearing shall be recorded, and a transcript shall be furnished to the bank upon and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer(s). The presiding officer(s) may ask questions of any witness.

(iii) The presiding officer(s) may order that the hearing be continued for a reasonable period (normally five business days) following completion of oral testimony or argument to allow additional written submissions to the hearing record.

(8) *Recommendation of presiding officers.* Within 20 calendar days following the date the hearing and the record on the proceeding are closed, the presiding officer(s) shall make a recommendation to the Board on the reclassification.

(9) *Time for decision.* No later than 60 calendar days after the date the record is closed or the date of the response in a case where no hearing was requested, the Board will decide whether to reclassify the bank and notify the bank of the Board's decision.

(b) *Procedures for reclassifying a state member bank based on unsafe and unsound practice.*—(1) *Issuance of notice of proposed reclassification.* If the Board determines to reclassify a well capitalized state member bank as adequately capitalized or to require an adequately capitalized or undercapitalized state member bank to comply with supervisory actions as if it were in the next lower capital category pursuant to section 38(g) of the FDI Act and § 208.33(c)(2) of Regulation H (12 CFR 208.33(c)(2)) because the Board deems the bank to be engaging in an unsafe or unsound practice (each of the foregoing referred to hereinafter as a "reclassification"), the Board will issue and serve on the bank a written notice of the Board's intention to reclassify the bank.

(2) *Contents of notice.* A notice of intention to reclassify a bank will include:

(i) A statement of the bank's capital measures and capital levels and the category to which the bank would be reclassified;

(ii) The reasons for reclassification of the bank;

(iii) The date by which the bank subject to the notice of reclassification may file with the Board a written appeal of the proposed reclassification, which shall be at least 14 calendar days from the date of service of the notice unless the Board determines that a shorter period is appropriate in light of the financial condition of the bank or other relevant circumstances.

(3) *Response to notice of proposed reclassification based on unsafe and unsound practice.* A bank may file a written response to a notice of proposed reclassification issued under this subsection within the time period set by the Board. The response should include:

(i) An explanation of the steps taken by the bank to address the deficiency described in the notice of proposed reclassification or of the reasons that the reclassification is not otherwise appropriate;

(ii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank or company regarding the reclassification.

(4) *Faiure to file response.* Failure by a bank to file, within the specified time period, a written response with the Board to a notice of proposed reclassification under this subsection shall constitute a waiver of the opportunity to respond and shall constitute consent to the reclassification.

(5) *Board consideration of response.* After considering the response, the Board may:

(i) Issue a written order to the bank reclassifying the bank to a different capital category as provided in section 38(g) of the FDI Act;

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(ii) Determine not to reclassify the bank and so notify the bank; or

(iii) Seek additional information or clarification of the response from the bank or company, or any other relevant source.

(c) *Request for rescission of reclassification.* Any bank that has been reclassified under this section, may, upon a change in circumstances, request in writing that the Board reconsider the reclassification, and may propose that the reclassification be rescinded and that any directives issued in connection with that reclassification be modified, rescinded, or removed. Unless otherwise ordered by the Board, the bank shall remain subject to the reclassification and to any directives issued in connection with that reclassification while such request is pending before the Board.

§ 263.203 Order to dismiss a director or senior executive officer.

(a) *Service of notice.* When the Board issues and serves a directive on a state member bank pursuant to § 263.201 requiring the bank to dismiss from office any director or senior executive officer under section 38(f)(2)(F)(ii) of the FDI Act, the Board will also serve a copy of the directive, or the relevant portions of the directive where appropriate, upon the person to be dismissed.

(b) *Response to directive.* A director or senior executive officer who has been served with a directive under paragraph (a) of this section ("Respondent") may file a written request for reinstatement. The request for reinstatement must be filed within 10 calendar days of the receipt of the directive by the Respondent, unless further time is allowed by the Board at the request of the Respondent. The request for reinstatement should include reasons why the Respondent should be reinstated, and may request an informal hearing before the Board or its designee under this section. If the Respondent desires to present oral testimony or witnesses at the hearing, the Respondent must include a request to do so with the request for an informal hearing. The request to present oral testimony or witnesses shall specify the names of the witnesses and the general nature of their expected testimony. Failure to request a hearing shall constitute a waiver of any right to a hearing and failure to request the opportunity to present oral testimony or witnesses shall constitute a waiver of any right or opportunity to present oral testimony or witnesses. Unless otherwise ordered by the Board, the dismissal shall remain in effect while a request for reinstatement made under this section is pending.

(c) *Order for informal hearing.* Upon receipt of a timely written request from a Respondent for an informal hearing on the portion of a directive requiring a bank to dismiss from office any director or senior executive officer, the Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the Respondent requests a later date. The hearing shall be held in Washington, D.C., or at such other place as may be designated by the Board, before a presiding officer(s) designated by the Board to conduct the hearing.

(d) *Hearing procedures.* (1) A Respondent may appear at the hearing personally or through counsel. A Respondent shall have the right to introduce relevant written materials and to present oral argument. A Respondent may introduce oral testimony and present witnesses only if expressly authorized by the Board or the presiding officer(s). Neither the provisions of the Administrative Procedure Act governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure in subpart A of this part apply to an informal hearing under this section unless the Board orders that such procedures shall apply.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer(s). The presiding officer(s) may ask questions of any witness.

(3) The presiding officer(s) may order that the hearing be continued for a reasonable period (normally five business days) following completion of oral testimony or argument to allow additional written submissions to the hearing record.

(e) *Standard for review.* A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the bank would materially strengthen the bank's ability—

(1) To become adequately capitalized, to the extent that the directive was issued as a result of the bank's capital level or failure to submit or implement a capital restoration plan; and

(2) To correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of classification of the bank based on supervisory criteria other than capital, pursuant to section 38(g) of the FDI Act.

(f) *Limitation on scope of review.* The level of capital or the capital category assigned to the state member bank with which a Respondent is associated shall not be subject to review in any proceeding under this section.

(g) *Recommendation of presiding officers.* Within 20 calendar days following the date the hearing and the record on the proceeding are closed, the presiding officer(s) shall make a recommendation to the Board concerning the Respondent's request for reinstatement with the bank.

(h) *Time for decision.* Not later than 60 calendar days after the date the record is closed or the date of the response in a case where no hearing has been requested, the Board shall grant or deny the request for reinstatement and notify the Respondent of the Board's decision. If the Board denies the request for reinstatement, the Board shall set forth in the notification the reasons for the Board's action.

§ 263.204 Enforcement of directives.

(a) *Judicial remedies.* Whenever a state member bank or company that controls a state member bank fails to comply with a directive issued under section 38, the Board may seek enforcement of the directive in the appropriate United States district court pursuant to section 8(i)(1) of the FDI Act.

(b) *Administrative remedies.* Pursuant to section 8(i)(2)(A) of the FDI Act, the Board may assess a civil money penalty against any state member bank or company that controls a state member bank that violates or otherwise fails to comply with any final directive issued under section 38 and against any institution-affiliated party who participates in such violation or noncompliance. The failure of a bank to implement a capital restoration plan required under section 38, subpart B of Regulation H (12 CFR part 208, subpart B), or this subpart, or the failure of a company having control of a bank to fulfill a guarantee of a capital restoration plan made pursuant to section 38(e)(2) of the FDI Act shall subject the bank or company to the assessment of civil money penalties pursuant to section 8(i)(2)(A) of the FDI Act.

(c) *Other enforcement action.* In

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addition to the actions described in paragraphs (a) and (b) of this section, the Board may seek enforcement of the provisions of section 38 or subpart B of Regulation H (12 CFR part 208, subpart B) through any other judicial or administrative proceeding authorized by law.

By order of the Board of Governors of the Federal Reserve System.

Dated: June 25, 1992.

Jennifer J. Johnson,

Associate Secretary of the Board.

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