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ARNOLD & PORTER LLP

ADVISORY **July 2010**

FDIC Approves Revised Interagency Memorandum of Understanding on its Backup Supervision Authority

On July 12, 2010, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) approved a revised Interagency Memorandum of Understanding (MOU) to enhance the FDIC's existing backup authorities over insured depository institutions (IDIs) that it does not directly supervise. The revised MOU would increase the FDIC's access to information in certain circumstances and establish an expanded on-site FDIC staff presence at large, complex IDIs. The MOU is intended to enable the FDIC to, among other things, carry out "the responsibilities assigned to the FDIC under the Dodd-Frank Wall Street Reform and Consumer Protection Act" and to address perceived shortcomings in interagency coordination that were identified in prominent thrift failures.

This advisory provides a brief summary of the revised MOU.

Covered Insured Depository Institutions

The four groups of IDIs covered by the revised MOU are as follows:

***Problem IDIs*.** This group consists of IDIs that have a composite CAMELS rating of "3," "4," or "5," or that are undercapitalized as defined under the Prompt Corrective Action standards set forth in Section 38 of the Federal Deposit Insurance Act and its implementing regulations (i.e., below 4 percent tier 1 leverage or risk-based capital, or 8 percent total risk-based capital).

***Heightened Insurance Risk IDIs*.** This group is defined as:

(i) large institutions with a CAMELS rating of "1" or "2" (i.e., IDIs with assets of $10 billion or more) if their initial assessment rate (IAR) is in the top 66 percent of the IAR range; and

(ii) institutions with assets of less than $10 billion (small institutions) that have a CAMELS

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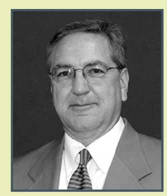

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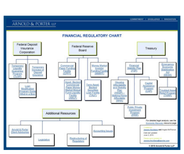

Financial Regulatory Chart

Financial Regulatory Reform: *For Arnold & Porter's latest resources on this topic including Advisories, upcoming events, and publications, please visit Financial Regulatory Reform. Also visit our Financial Regulatory Chart, which aggregates information on US government programs.*

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rating of a "2" and where the FDIC's Statistical CAMELS off-site rating (SCOR)[1] indicates their probability of downgrade is 50 percent or greater or their rank according to the FDIC's Growth Monitoring System (GMS) is in the 98th percentile.[2]

Large IDIs. This group consists of certain large institutions where a Basel II "Advanced Approach" is mandated,[3] and IDI subsidiaries of any non-bank financial company or large interconnected bank holding company recommended by the Financial Stability Oversight Council for heightened prudential standards under Section 115(a)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act as may be agreed upon from time to time by the FDIC and the relevant primary federal bank regulator (PFR).[4]

TLGP-IDIs. This group consists of IDIs that are affiliated with entities that have had greater than $5 billion of borrowings under the FDIC's Temporary Liquidity Guarantee Program (TLGP).

1 The SCOR system is an off-site statistical model that is used by the primary federal bank regulators to supplement their on-site examinations of depository institutions. The major objective of the SCOR system is to identify the "1"- and "2"-rated institutions that are in danger of being downgraded to "3" or worse. SCOR compares an institution's examination ratings with its financial ratios of the previous year, identifies the financial ratios that were most closely related to examination ratings, and uses that relationship to forecast future ratings.

2 The GMS was designed to detect the initial stage in the life cycle of failing banks—the rapid-growth stage. Banks that GMS identifies as rapid-growth institutions because of loan concentrations in risky areas or management lapses are flagged for off-site review. The GMS identifies such institutions based upon the levels and quarterly trends of certain growth rates and financial ratios.

3 The Basel II Advanced Approach is required for a core group of large and internationally active US banking organizations. The Advanced Approach that the core banks must use consists of the advanced internal ratings-based approach to calculate regulatory credit risk capital requirements and the advanced measurement approach to calculate regulatory operational risk capital requirements. "Core banks" are defined as banking organizations with consolidated total assets (excluding assets held by an insurance underwriting subsidiary of a bank holding company) of $250 billion or more, or with consolidated total on balance sheet foreign exposure of $10 billion or more. A bank must also apply the Advanced Approach if it is a subsidiary of another bank or bank holding company that uses the Advanced Approach, unless it is exempted by its primary federal supervisor from being required to use the Advanced Approach.

4 The PFRs are the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Board of Governors of the Federal Reserve System.

Scope of Special Examination

The FDIC will conduct targeted reviews for insurance purposes on Problem IDIs and Heightened Risk IDIs. The FDIC will focus on gathering and evaluating information (i) to determine the risk that is presented to the FDIC's Deposit Insurance Fund (DIF); (ii) to price deposit insurance; (iii) to assess the probability of default; (iv) to estimate any potential loss to the DIF; (v) to develop contingent resolution plans; and (vi) for such other matters that are necessary for deposit insurance purposes. The FDIC is required to notify the PFR before it obtains any information directly from the IDI and explain why it needs additional information beyond what the PFR has made available.

At Large IDIs and TLGP-IDIs, the FDIC will establish a continuous on-site staff presence. The number of FDIC staffers assigned to such an institution will depend on the size of the IDI. The FDIC will assign no more than (i) five full-time on-site staffers at IDIs with US holding companies that have total assets of $750 billion or more; and (ii) three full time on-site staffers for Large IDIs with US holding companies that have total assets of less than $750 billion. The FDIC may assign additional staffers subject to mutual agreement between the FDIC and the PFR. The FDIC may also assign temporary additional staff as it deems necessary.

Coordination and Information Sharing

The revised MOU requires the FDIC to inform a PFR of its special examination planning and provide reasonable prior notice to the PFR of any unscheduled special examinations. Likewise, each PFR will inform the FDIC of its examination planning and scoping activities, and provide prior notice of unscheduled special exams and of meetings with boards of directors of IDIs. The FDIC must also provide the PFR with access to the results of its special examinations, including material deposit insurance related issues and risk assessments. Either the FDIC or the PFR may request to participate in any examinations or meetings with IDI personnel conducted by the other agency. If the PFR declines the FDIC's request to participate then the FDIC must provide reasonable notice before conducting the examination or meeting on its own. Additionally, the FDIC must share with the PFRs, on a quarterly basis, lists of all the IDIs in the four groups covered by the MOU.

The MOU explicitly recognizes that the FDIC has the authority under Section 10(b)(3) of the Federal Deposit Insurance Act, 12 U.S.C. § 1820(b)(3), to conduct a special examination whenever the Board of Directors of the FDIC determines a special examination to be necessary to determine the condition of a depository institution for insurance purposes whether or not the institution fits in one of the four categories covered by the MOU.

CAMELS Rating Differences

If the FDIC's CAMELS ratings for an institution differ from a PFR's assigned ratings, the FDIC is required to provide the PFR with an explanation of the basis for the FDIC's position. In the event of a disagreement, the matter must be referred to the FDIC Director of the Division of Supervision and Consumer Protection (Director), or other designee, and the appropriate supervision official of the PFR. Any decision by the FDIC to use an assigned rating different than the PFR's rating must be made by the Director (or other designee), after consultation with the Chairman of the FDIC.

We hope that you find this advisory helpful. For further information, please contact:

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