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Risk Assessment and Intervention

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Key Themes in US Approach to Risk Assessment and Intervention

Risk Assessment and
Intervention in the US

Overview of FDIC

Risk-focused supervision

On-site examinations and off-site surveillance

Intervention

Prompt Corrective Action



Overview of FDIC - Role and Mission

FDIC Mandate and Supervisory Approach

- FDIC role and mission is to maintain stability and public confidence in the US banking system.
- Determine the strength of the banking industry and health of the deposit insurance system by continuously assessing the impact of economic factors and banking risks as revealed by on-site examinations and offsite monitoring efforts.

Overview of FDIC:

FDIC's Primary Responsibilities



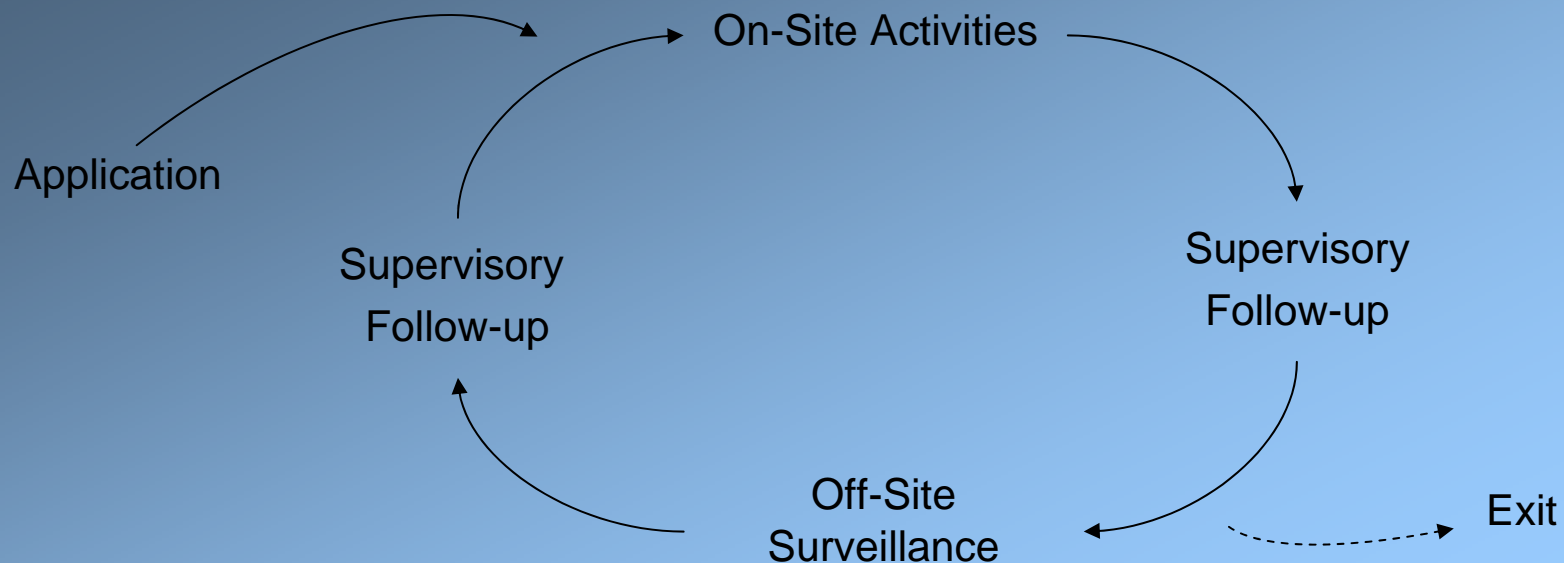
Provide Federal deposit insurance for banks and savings associations in the United States.

Perform duties of Receiver for failed banks and thrifts and then liquidate assets.



Supervise banks for safety and soundness and enforce consumer protection laws at state-chartered nonmember banks.

Coordinated Risk-Focused Supervision Throughout an Institution's Life Cycle



Risk-focused supervision: Guarding entry into the banking system

Deposit Insurance and Licensing Applications

Seven Statutory Factors Must be Considered:

- Financial History and Condition
- Adequacy of Capital Structure
- Future Earnings Prospects
- General Character of Management
- Risk to Deposit Insurance Funds
- Convenience and Needs of Community
- Consistency with Powers in FDI Act



Risk-focused supervision:

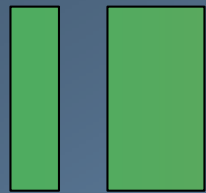
On-site Examinations

Key On-site Examination Principles

- **Frequent on-site visits**
 - Exams conducted every 12 – 18 months
 - Large and complex banks: around-the-clock on-site presence
 - Risk-based approach
- **Emphasis on planning and early risk identification**
 - Pre-exam meetings with senior bank management
 - Evaluate economic and competitive influences and assess changes in risk profile
 - Establish priorities and assemble staff (may require specific skill sets)
 - Communicate proposed examination strategy to field/regional office management

Risk-focused supervision: On-site Examinations

As CAMELS rating becomes more severe



1 2 3 4 5

Supervisory response becomes more severe

- Regular exam frequency and scope
- Routine off-site monitoring
- Routine regulatory reporting
- Enforcement action unlikely

- Exam frequency may be increased and scope broadened
- Increased off-site monitoring
- Quarterly, or more frequent, progress reports may be required
- Informal enforcement action likely

- Exam frequency increased and scope deepened
- Targeted visits and reviews very likely
- Close and frequent off-site monitoring
- Quarterly, or more frequent, progress reports required
- Formal enforcement action certain



Risk-focused supervision: Off-site Surveillance

Purpose of FDIC's Offsite Programs

- Provide early warnings of emerging conditions at bank-specific level exposure.
- Analyze macro information at the local, regional, or national level.
- Plan examination scope, duration, resources, and timing.

Sources of Information

- **Quarterly Financial Reports: Call Reports / Thrift Financial Reports**
- **Market information**



Risk-focused supervision: Off-site Surveillance

Specialized Large Bank Supervision Program

Large banks (banks having more than \$10 billion in assets) pose significantly greater risk to the deposit insurance fund and warrant continuous scrutiny.

Monitoring systems for large banks include:

- Large Insured Depository Institution Program
- Dedicated Examiner Program
- Shared National Credit Program



Intervention



Learning from our history

The FDIC's History of the Eighties study has taught us that:

- Problems must be identified at an early stage if serious deterioration in an institution's condition is to be prevented, and early identification requires continuous and sometimes burdensome monitoring of the institution's activities.
- The ability to curb excessive risk taking on the part of currently healthy institutions was (and continues to be) limited by the problem of identifying risky activities before they produce serious losses.

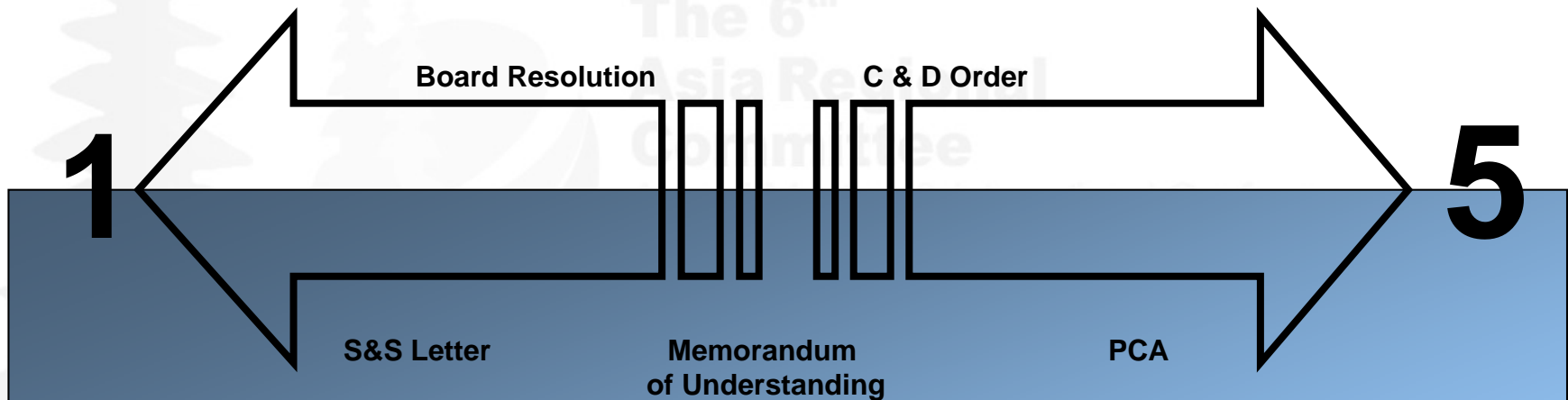
The FDIC's approach, therefore, is designed to promptly identify and address practices, conditions, or violations of law that could result in risk of loss or damage to a financial institution.

What Happens To Weak Banks?

Most often, supervisory enforcement actions and bank resolution efforts do not result in receivership

- Corrective actions may be sufficient to return the institution to a safe and sound condition.
- The institution may be acquired by or merged into a stronger institution or company.
- The institution may be self-liquidated with no impact to the deposit insurance fund.

Supervisory Enforcement Actions are Generally Correlated to the Rating



Among the arguments in favor of more stringent action:

- Unfavorable trends in the institution’s risk tolerance;
- Entry into new high-risk activities; and
- Violations of critical laws.

Actions against abusive individuals or affiliated parties are always considered, regardless of the assigned rating.



Enforcement Tools at the FDIC's Disposal

Informal Agreements with Bank

- Commitment or Supervisory Letter
- Board Resolution
- Memorandum of Understanding

Formal – Legally Enforceable Actions

- Written Agreement
- Cease and Desist Order
- Prompt Corrective Action Directive
- Safety and Soundness Letter
- Termination of Insurance
- Civil Money Penalty
- Removal and Prohibition

Other Supervisory Tools and Options

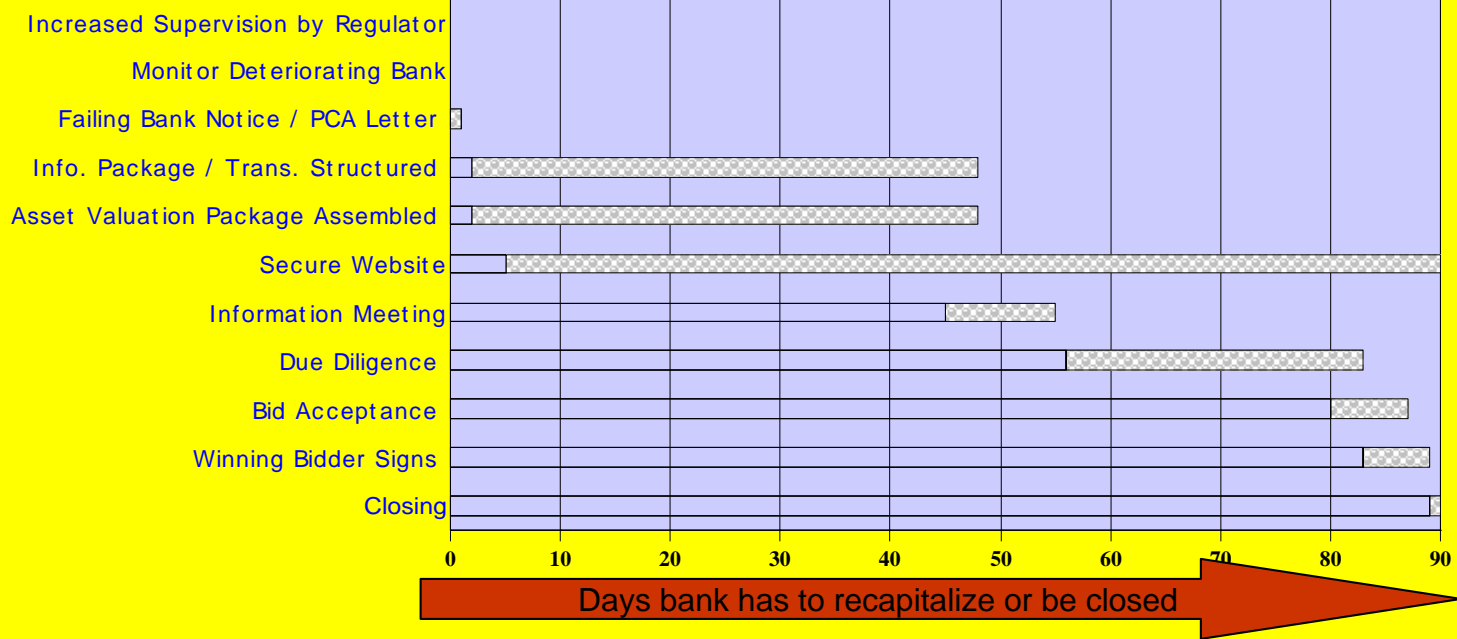
- Investigations
- Suspicious Activity Report
- Referral to Another Agency
- Complaint to Professional Board



Intervention: Problem Banks

What Happens To Weak Banks?

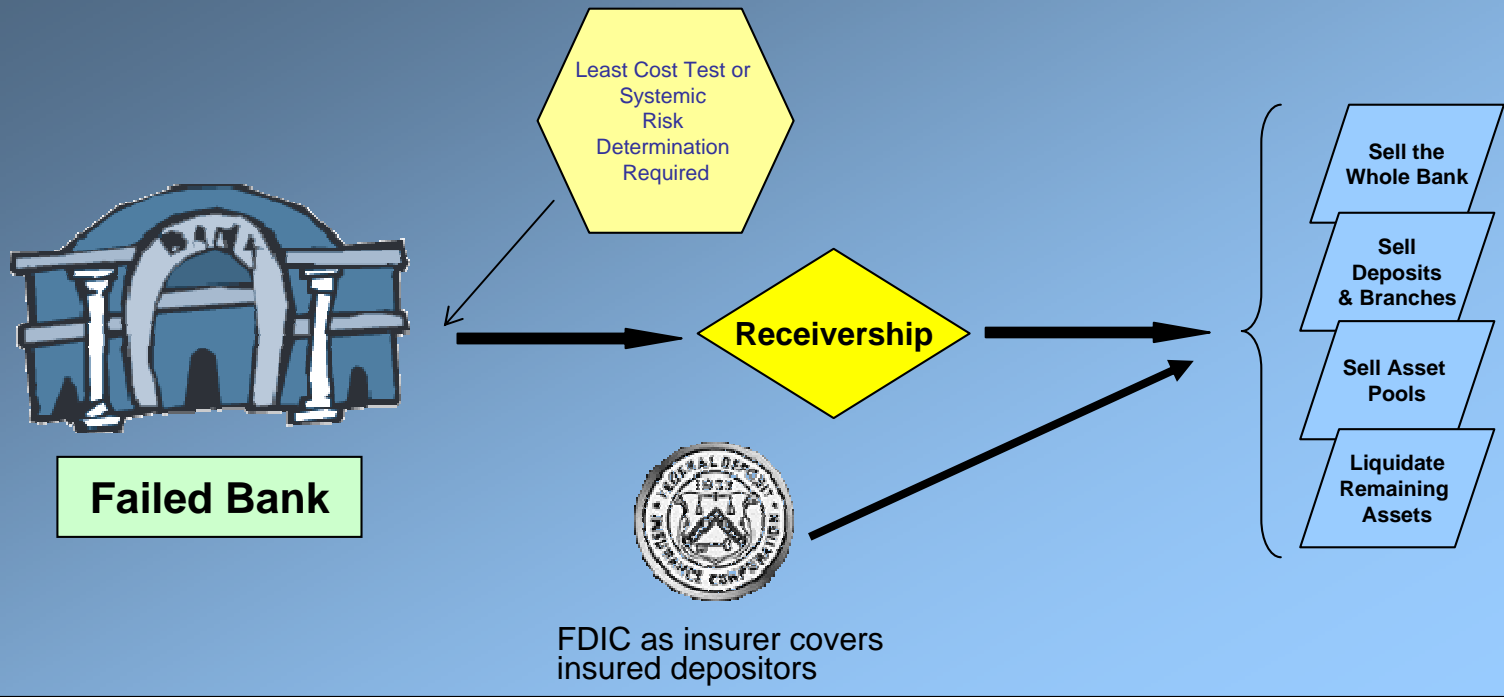
Banks that are not viable enter into receivership and when possible proceed through an orderly process.



Intervention: Problem Banks

What Happens To Weak Banks?

Final Stage: Bank Enters into Receivership



Intervention: Problem Banks

- **FDIC closely monitors “Troubled Institutions,” which include those that are rated 3, 4, or 5; these institutions are generally subject to corrective programs.**
- **Supervisory tools used to identify and monitor troubled institutions and coordinate the oversight process include:**
 - **Problem Bank Reports and Memoranda**
 - **Risk-focused review and monitoring**
 - **Projected Failure Reports**
 - **Coordination with the FDIC’s Division of Resolutions and Receiverships**
 - **Interagency Problem Bank Meetings**

Intervention: Prompt Corrective Action

Prompt Corrective Action

Prompt Corrective Action (PCA) is intended to minimize the cost of resolving bank failures and limit regulatory forbearance by requiring more timely closure of failing institutions and earlier intervention in problem banks.

Statute requires and authorizes the FDIC to initiate specific supervisory actions for institutions that are not adequately capitalized.

In the aftermath of the US Savings and Loan Crisis – several weaknesses came to light

Moral Hazard

Regulatory Forbearance

Resulted in \$153 billion cost to the deposit insurer and tax payers.



Intervention: Prompt Corrective Action

Prompt Corrective Action

A bank's capital position is used to determine the type and severity of supervisory action that may be required

	Total RBC	Tier 1 RBC	Leverage Ratio
Well Capitalized	≥10%	≥6%	≥5%
Adequately Capitalized	≥8%	≥4%	≥4%
Undercapitalized	<8%	<4%	<4%
Significantly Undercapitalized	<6%	<3%	<3%
Critically Undercapitalized	Tangible Equity Capital		<2%

Capital Plans are Required for All Undercapitalized Categories.



Intervention: Prompt Corrective Action

Prompt Corrective Action

Prompt Corrective Action (PCA)

PCA requires supervisory intervention at an early stage as indicated by a bank's capital position. Supervisory actions escalate in proportion to the bank's risk level. Some of these actions are mandatory, while others are discretionary.

A key point is that supervisors are required to intervene while the bank is believed to have positive economic capital, which lessens the cost to the insurer.

Summary of Prompt Corrective Action Provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991

Zone	Mandatory provisions	Discretionary provisions	Capital ratios (percent)		
			Risk-based Total	Leverage Tier 1	Leverage Tier 1
1. Well-capitalized			>10	>6	>5
2. Adequately capitalized	1. No brokered deposits, except with FDIC approval		>8	>4	>4
3. Undercapitalized	1. Suspend dividends and management fees 2. Require capital restoration plan 3. Restrict asset growth 4. Approval required for acquisitions, branching, and new activities 5. No brokered deposits	1. Order recapitalization 2. Restrict interaffiliate transactions 3. Restrict deposit interest rates 4. Restrict certain other activities 5. Any other action that would better carry out prompt corrective action	<8	<4	<4
4. Significantly undercapitalized	1. Same as for zone 3 2. Order recapitalization ¹ 3. Restrict interaffiliate transactions ¹ 4. Restrict deposit interest rates ¹ 5. Pay of officers restricted	1. Any zone 3 discretionary actions 2. Conservatorship or receivership if bank fails to submit or implement plan or recapitalize pursuant to order 3. Any other zone 5 provision if such action is necessary to carry out prompt corrective action	<6	<3	<3
5. Critically undercapitalized	1. Same as for zone 4 2. Receiver/conservator within 90 days ² 3. Receiver if still in zone 5 four quarters after becoming critically undercapitalized 4. Suspend payments on subordinated debt ¹ 5. Restrict certain other activities				<2

¹ Not required if primary supervisor determines action would not serve purpose of prompt corrective action or if certain other conditions are met.



Intervention: Prompt Corrective Action

Prompt Corrective Action

Supervisory actions become increasingly severe as an institution falls through the undercapitalized categories.

Under Prompt Corrective Action the FDIC can:

- Restrict activities;
 - Restrict asset growth;
 - Restrict deposit rates;
 - Restrict transactions with affiliates;
 - Require approval of material transactions;
 - Require divestiture; or
 - Dismiss Directors and Senior Officers.
- Issue Supervisory Directives;
 - Issue Cease and Desist Orders; or
 - Appoint FDIC as Receiver.



Intervention: Prompt Corrective Action



Typical Grounds for Closing Bank and Appointment of Receiver

- Critically undercapitalized under Prompt Corrective Action statute
 - Trigger: Tangible Capital < 2% Total Assets
 - Must recap within 90 days or face closure
- Grounds for immediate bank closure:
 - Assets insufficient to meet obligations (Liquidity insufficient)
 - Unsafe or unsound banking practices
 - Willful violation of a Cease & Desist Order
 - Concealment of books, records, money laundering, etc.
 - Need for FDIC self-appointment