FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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FDIC ADOPTS FINAL "PROMPT CORRECTIVE ACTION" RULE

The FDIC Board of Directors today approved a final rule implementing a statutory requirement that banking regulators take specified "prompt corrective action" when an insured institution's capital falls to certain levels. Similar rules have been adopted by the Federal Reserve Board and are in the process of being adopted by the Office of the Comptroller of the Currency and the Office of Thrift Supervision for the institutions they supervise.

Under Section 131 of the FDIC Improvement Act of 1991 (FDICIA), restrictions and prohibitions on an insured bank or thrift become more severe as the institution's capital level declines. The sanctions begin with measures such as restrictions on dividends and management fees (if the payments would result in the institution's becoming undercapitalized) and ultimately result in the closing of institutions that are critically undercapitalized.

FDIC Chairman Andrew C. Hove, Jr., said today: "The chief aims of the congressional sanctions are to resolve problems of insured institutions as early as possible and at the lowest possible long-term cost to the insurance funds. Although we expect some banks on the verge of failing to be closed earlier as a result of this new law, our hope is that the threat of sanctions will encourage many other weak institutions to take actions on their own to correct their deficiencies."

The FDIC's rule applies primarily to state-chartered banks and insured branches of foreign banks that are supervised by the agency, as well as to directors, officers and employees of these institutions. However, portions of the FDIC rule also apply to all insured depository institutions that are deemed to be "critically undercapitalized."

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The FDIC's final rule, which becomes effective December 19, 1992, defines five categories of institutions for purposes of implementing the prompt corrective action requirements:

o Well capitalized: This institution has a total risk-based capital ratio (the ratio of total capital to risk-weighted assets) of at least 10 percent, a Tier 1 risk-based ratio (the ratio of Tier 1 or "core" capital to risk-weighted assets) of at least six percent, a leverage ratio (the ratio of Tier 1 capital to total assets) of at least five percent and it is not subject to any written agreement, order or directive from its regulator to meet and maintain a specific capital level.

o Adequately capitalized: This institution meets all required minimum capital levels but does not meet the definition of a "well capitalized" institution. For banks, those minimum capital levels (when fully phased in at year-end 1992) generally will require a total risk-based capital ratio of at least eight percent, a Tier 1 risk-based ratio of at least four percent and a leverage ratio of at least four percent.

o Undercapitalized: This institution fails to meet one or more of the required minimum capital levels to be defined as adequately capitalized. FDICIA mandates that an undercapitalized institution be subject to restrictions on dividend and management fees, asset growth restrictions, and prohibitions against making acquisitions, opening branches or engaging in new lines of business without the prior approval of its primary federal regulator.

o Significantly undercapitalized: This institution has a total risk-based capital ratio of less than six percent, a Tier 1 risk-based capital ratio of less than three percent, or a leverage ratio of less than three percent. Significantly undercapitalized institutions are subject to the restrictions that automatically apply to undercapitalized banks and thrifts, as well as to other limitations that include mandatory prohibitions against the payment of bonuses and raises to senior executive officers without the regulator's prior approval.

o <u>Critically undercapitalized</u>: This institution has a "tangible equity" to total assets ratio of two percent or less. Tangible equity is a newly defined term to be used only for determining which institutions are critically undercapitalized. Tangible equity combines elements of core capital (such as common equity capital) and cumulative perpetual preferred stock minus all intangible assets except for limited amounts of purchased mortgage servicing rights. Critically undercapitalized institutions are subject to the restrictions that apply to undercapitalized and significantly undercapitalized institutions, as well as to other prohibitions that the FDIC has been given authority to enforce as the insurer of deposits.

For example, <u>any</u> critically undercapitalized institution, regardless of its primary federal regulator, must receive prior written approval from the FDIC before it can take actions that include: engaging in any material transactions other than in the usual course of business, extending credit for highly leveraged transactions (HLTs), amending its charter or bylaws, making any material changes in accounting methods, engaging in certain transactions with affiliates, paying excessive compensation or bonuses, or paying above-market interest rates on deposits. Under FDICIA, a critically undercapitalized institution generally is prevented from paying principal and interest on its subordinated debt and will be placed in conservatorship or receivership if its capital level is not increased within a prescribed time limit.

Based on the most recent financial reports that institutions have filed with the regulators (as of June 30, 1992), the FDIC estimates that about 98 percent of the nation's 12,000 insured banks (commercial banks and savings banks) and 90 percent of the 2,000 insured thrifts have capital levels fitting the statistical requirements for being well capitalized or adequately capitalized. The two percent of the banks with capital ratios that would place them in one of the three categories for undercapitalized institutions have combined assets of about $93 billion. The 10 percent of the thrifts whose capital levels would put them in one of the three categories for undercapitalized institutions have combined assets of about $135 billion.

However, the actual number of institutions that will be subject to the limitations for undercapitalized institutions may be higher because of provisions in FDICIA that allow the agencies to "downgrade" other institutions under certain circumstances. For example, the restrictions for undercapitalized institutions may be applied to an institution that meets minimum capital requirements but otherwise is in a less-than-satisfactory condition, such as one that has significant asset quality problems.

The final rule also includes procedures for issuing and contesting "prompt corrective action" directives. Such directives include those from the FDIC requiring an institution to dismiss directors and senior executive officers.

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