TB 36 was rescinded by RB 3a-1 and TB 36a. Click HERE to link to TB 36a.

Handbook: Thrift Activities
Subject: Capital Adequacy

Section: 320
TB 36

November 3, 1989

Guidelines for FIRREA Capital Plans, Exemptions and Exceptions

RESCINDED

Summary: The Director of OTS shall treat as an unsafe and unsound practice any failure by a savings association to file an acceptable capital plan and to comply with the guidelines set forth below.

For Further Information Contact:
Your District Office or the Supervision Operations Division of OTS, Washington, D.C.

Thrift Bulletin 36

<u>Background:</u>

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Section 301, amends the Home Owners' Loan Act of 1933, effective August 9, 1989.

Upon adoption of the new capital regulation required by FIRREA, any savings association that is not in compliance with all of the capital standards will be considered an association that requires more than normal supervision and will be deemed to fail its minimum capital requirements and shall not, without the prior written approval of its District Director: (1) grow beyond net interest credited, (2) make any capital distributions, or (3) act inconsistently with any applicable operating restrictions and limitations, including restrictions imposed by the District Director, under current delegations of authority.

For purposes of this Bulletin, an association shall require more than normal supervision if it fails any one of its minimum capital requirements, has a MACRO rating of 4 or 5, or is otherwise identified as in need of more than normal supervision by supervisory personnel.

FIRREA requires that a savings association that fails any one of the capital standards shall submit a capital plan and may apply for a limited capital exception, an exemption from a supervisory sanction or restriction, or a limited growth exception.

Acceptable Capital Plan: Any savings association not in compliance with the capital standards shall have 60 days from the effective date of the newly adopted capital regulation (or the date that the savings association falls out of compliance with the capital standards) to submit a capital plan to the District Director.* A savings association that files and adheres to a capital plan that is acceptable to the District Director and receives approval of a capital exception or exemption shall be deemed to be in compliance with its capital standards.

Capital Exception: FIRREA provides the Director of OTS with the authority to make temporary exceptions, not to extend beyond December 31, 1990, to the capital standards for eligible savings associations. A capital exception request would include any request for an exception from complying with the capital standards established in Section 5(t) of the Home Owners' Loan Act of 1933, 12 U.S.C. 1464 (t). The authority to grant capital exceptions will only be used in extraordinary situations.

Capital Exemption: A savings association may apply to the District Director for an exemption from a capital directive or specific sanctions and penalties imposed upon the savings association for failure to comply with its minimum capital standards. A savings association that receives approval of a capital exemption and operates in accordance with an acceptable capital plan will require more than normal supervision, but will be deemed to be in compliance with its capital standards only for the purposes of the capital regulation. The savings association must request and receive approval of specific, express exemptions from the provisions of other rules, regulations and policy statements as part of the accepted capital plan to be deemed in capital compliance for purposes of such other rules, regulations and policy statements. Notwithstanding an approval of a capital exemption, all asset growth restrictions shall apply unless such approval specifically states otherwise.

Pursuant to Section 5(t)(7)(c)(i), the Director of OTS may approve an application for a capital exemption if the following are applicable: (1) such exemption would pose no significant risk to the affected insurance fund; (2) the savings association's management is competent; (3) the savings association is in substantial compliance with all applicable statutes, regulations, orders and supervisory agreements and directives; and (4) the savings association's management has not engaged in insider dealing, speculative practices, or any other activities that have jeopardized the association's safety and soundness or contributed to impairing the association's capital.

Any application for a capital exemption must be accompanied by an acceptable capital plan. The general requirements, set forth in FIRREA, for any capital are as follows:

1. Address the savings association's need for increased capital;

2. Describe the manner in which the savings association will increase its capital so as to achieve compliance with capital standards;

3. Specify the types and levels of activities in which the savings association will engage;

4. Require any increase in assets to be accompanied by an increase in tangible capital not less in percentage amount than the leverage limit then applicable; and

5. Require any increase in assets to be accompanied by an increase in capital, as defined under a risk-based capital rule as adopted, not less in percentage amount than required under the risk-based capital standard then applicable.

Limited Growth Exception: Prior to January 1, 1991, a savings association that fails its minimum capital requirements shall not increase its assets in an amount exceeding the amount of net interest credited to its deposit liabilities without prior written approval, by the District Director, of a limited growth exception (as provided in Regulatory Bulletin 3a). After December 31, 1990, a savings association that fails applicable capital standards shall not increase its assets unless it obtains prior written approval from the District Director to increase its assets up to an amount not to exceed the amount of net interest credited to its deposit liabilities.

Procedures:

All capital deficient savings associations shall submit capital plans to the appropriate District Director within 60 days following the effective date of the capital regulation or the date that the savings association falls out of compliance with the capital standards. Capital plans that raise significant issues of law or policy will be reviewed concurrently by Washington staff.

As a general rule, a plan will not present a significant policy issue if all of the following apply: (1) the plan demonstrates attainable goals and steady increases in capital based upon reasonable, explicit assumptions; (2) the plan demonstrates that the savings association's capital level will meet internal interim targets, acceptable to the District Director, set by management and the board of directors, that enable progress to be measured on a quarterly basis; (3) any proposed increase in assets is accompanied by an increase in capital levels sufficient to meet the applicable capitalization requirements set forth under FIRREA; (4) the plan is not filed with an application for a significant transaction including, but not limited to, an acquisition, merger, conversion, or branch purchase; (5) the plan is not filed with an application for an exemption from any rule, regulation, or policy statement other than an application for a capital exemption or a limited growth exception; and (6) the plan demonstrates that the savings association's capital level meets or exceeds all applicable capital standards as quickly as reasonably possible, but in no event later than December 31, 1994, through safe and sound operations.

Contents of the Capital Plan:

The capital plan should explain in detail the proposed strategies for raising capital and for accomplishing the overall objectives of the savings association. Over-reliance on consultants by the board of directors and management for preparation of the plan is discouraged and may raise a supervisory issue with respect to managerial competence. An acceptable capital plan must be ratified by the board of directors of the savings association.

The capital plan should not be merely a budget of projected operations. It must be a comprehensive plan that is the result of strategic, in-depth planning on the part of the savings association's board of directors and management. The plan should describe a set of strategies and assumptions that have been made after a careful assessment of the available alternatives. All capital plans should include an analysis of the available strategies and a written summary as to why the selected strategies were chosen. Capital plans based upon overly optimistic projections regarding the ability to raise capital through the sale of stock will be rejected if not fully supported by objective data acceptable to the District Director.

The financial projections provided in any capital plan should be prepared on a quarterly basis and in a format comparable to the Thrift Financial Quarterly Report, that covers, at a minimum, a period through the quarter in which it is anticipated that compliance with all applicable capital standards will be achieved. The projections should be based upon the continuation of the existing interest-rate and regional economic environments. In general, the following items should be addressed in any capital plan:

1. Demonstrate that the savings association can meet applicable capital standards by no later than December 31, 1994. All capital plans must set forth the manner and the

timing in which such capital increases will be achieved. If a capital plan involves achieving capital compliance in a manner other than through the retention of earnings, then an acceptable capital plan must provide that any strategy for raising capital will be implemented no later than December 31, 1990. Generally, a plan that relies solely on the retention of earnings will be acceptable if it is based upon realistic assumptions, past operating performance, safe and sound operations, and demonstrates capital compliance no later than December 31, 1994, without significantly increasing the risk profile of the savings association.

The District Director may require any savings association to comply with all capital standards at any time prior to December 31, 1994, in accordance with an acceptable capital plan. Any capital plan that does not demonstrate, to the satisfaction of the District Director, that the association will meet all capital standards by December 31, 1994 is unacceptable and will be deemed to be materially deficient;

2. Provide detailed information on the completed and planned steps to raise capital ratios [Note: If the plan requires steps other than the retention of earnings to meet the capital standards, such steps should be scheduled as early as practicable, but should be initiated no later than December 31, 1990];

3. Describe goals that include, among other things, progressive capital level targets throughout the term of the plan. Such targets must be reflected in the pro forma financial statements;

4. Prepare pro forma calculations for all of the savings association's capital requirements and indicate any excess or shortfall for each quarter under the plan;

5. Prepare pro forma financial statements regarding any contemplated transactions in accordance with generally accepted accounting principles (GAAP), as modified by OTS capital regulations. The District Director may require an independent accounting opinion, if appropriate;

6. Provide pro forma consolidated and unconsolidated financial statements for the savings association prepared in accordance with GAAP, as modified by OTS capital regulations. Consolidated statements must include each service corporation and subsidiary (refer to FIRREA and OTS capital regulations for guidance on separate capitalization required for certain subsidiaries and the consolidation of subsidiaries not separately capitalized);

7. Include consolidated financial statements for the immediately preceding four quarters;

8. Demonstrate compliance with any limitations/restrictions on activities and investments under FIRREA, current rules and regulations, or policy statements, if applicable. Such restrictions may include, but are not limited to, growth, direct investments, junk bond divestiture, nonresidential real property lending, and loans-to-one borrower limitations;

9. Demonstrate that any increase in assets will be immediately capitalized in accordance with the requirements set forth in FIRREA and the OTS capital regulations;

10. Describe the steps to be implemented for purposes of complying with Thrift Bulletin No. 13. Discuss the strategy of the savings association to control interest-rate risk; and

11. Describe in detail major projected changes in assets and liabilities and any capital distributions or related actions that the association plans to undertake during the time period that the plan is in effect.

Conditions of Acceptance:

The ability to prepare and successfully execute an acceptable plan is the savings association's opportunity to correct its capital deficiencies, prior to OTS taking supervisory or formal enforcement action.

The District Director may impose operating restrictions, or higher capital levels above the minimum capital requirements (under the individual minimum capital requirement authority) in connection with the acceptance of any capital plan. Generally, acceptance of a plan should be predicated upon certain conditions including, but not limited to, the following:

1. The management and the board of directors execute an operating agreement which may provide, among other things, that if specific targets within the plan are not met or the association takes any action that does not comport with the plan accepted herein, certain activities will be significantly restricted, a consent to merge agreement will be executed, or management and the board of directors will resign.

2. The board of directors and senior management for the savings association shall file an amendment, acceptable to the District Director, to the capital plan within 15 days following an event or circumstance that materially affects the validity of the capital plan or its underlying assumptions. At a minimum, the capital plan shall be reviewed and revised as necessary on an annual basis.

3. The savings association shall submit to the District Director, within

20 days following the close of each calendar quarter, quarterly variance reports comparing actual capital to the targets established in the capital plan. Failure to file such variance reports shall constitute an unsafe and unsound practice. Variances that the District Director deems to be material may be grounds for revoking acceptance of the capital plan.

4. The Director of OTS, or his designee, may take enforcement action against a savings association if his findings indicate that the savings association is engaging in unsafe or unsound practices or operating in an unsafe and unsound condition, for reasons other than the failure to comply with its capital requirements, notwithstanding the fact that the savings association may be operating in accordance with an acceptable capital plan.

5. Failure by a savings association to meet its interim capital targets as set forth in the capital plan will constitute an unsafe and unsound practice and may result in the termination of any accepted capital plan, capital exception, or exemption. Generally, upon failure by the savings association to meet the interim operating and capital targets established within its plan, the District Director may issue a notice of intent to terminate an accepted capital plan and any approval of a capital exception, exemption or related filings. The savings association shall be given 30 days to respond to the notice of intent. When, in the opinion of the District Director, the condition of the savings association so requires, the response period may be shortened. A response to the notice should include, at a minimum, a discussion of the reasons the savings association was unable to meet the established targets and a revised/modified capital plan that demonstrates capital compliance by a date acceptable to the District Director. Failure to respond within 30 days of receipt (or such other time period as may be specified) will constitute a waiver of any objection to termination of the capital plan and related approvals. After the closing date of the savings association's response period, the District Director will have up to 30 days to determine whether to accept the revised capital plan or to terminate the existing capital plan and related approvals.

6. Acceptance of the capital plan shall not constitute a waiver of the authority of the Director of the OTS, or his designee, to initiate supervisory action against the savings association for reasons other than failure to meet the capital standards.

7. The acceptance of a capital plan does not preclude the Director of OTS, or his designee, from taking any enforcement action when an event or circumstance poses undue risk to the safety or soundness of the association or insurance fund. Such events or circumstances may include (1) the failure of the savings association to comply with the capital plan, (2) internal or external factors that invalidate material assumptions of the capital plan, or (3) factors that adversely affect material assumptions of the capital plan, thereby causing the viability of the capital raising strategies or other significant provisions of the plan to be clearly unrealistic.

<u>Filing Process and Time Frames</u>:

Capital plans should be filed with the appropriate District Director. Upon receipt of a plan, OTS staff will have up to 20 days to review the filing and determine whether to request additional information. In the event that no additional information is requested, the capital plan will be acted upon within 50 days following the date that the plan is initially filed with the District Office.

The savings association will have 30 days to respond to a request for additional information. Within 30 days following receipt of additional information, the OTS staff will notify the savings association in writing whether the plan is acceptable. Failure by the savings association to respond to a request for additional information within 30 days will constitute a withdrawal of the capital plan and related filing(s) and result in the savings association being subject to the full range of supervisory and enforcement actions.

* Any association that is unable to meet the standards for capital plans imposed herein without government assistance should notify its District Director immediately and refrain from expending unnecessary resources.

Darrel W. Dochow

— Darrel W. Dochow
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