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Handbook: Thrift Activities
Subject: Capital Adequacy

Section: 320
TB 36a

March 8, 1990

Guidelines for FIRREA Capital Plan, 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RESCINDED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. Thrift Bulletin 36 (TB 36), dated November 6, 1989, is rescinded with the issuance of this Bulletin. The principal differences between TB 36 and TB 36a are noted in the attachment to this Bulletin.

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

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Background

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

As of December 7, 1989, the effective date 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 fails its minimum capital requirements and that requires more than normal supervision 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.

An association is responsible for determining whether it meets the applicable capital standards under the OTS capital regulations and subsequent guidance issued by OTS. OTS has issued a series of Thrift Bulletins (TB No. 38 Series) that set forth additional guidance for purposes of determining an association's capital position in accordance with the capital regulation. Specifically, Thrift Bulletin 38-2 (Capital Adequacy: Guidance on the Status of Capital and Accounting Forbearances and Capital Instruments Held by a Deposit Insurance Fund) states that Section 5(t) of the HOLA eliminates all capital and accounting forbearances. Accordingly, capital and accounting forbearances must be eliminated in determining whether an association complies with the new capital regulation.

FIRREA requires that a savings association that fails any one of its applicable capital standards, including an individual minimum capital requirement (collectively referred to as the "capital standards"), must submit a capital plan and may apply for a limited capital exception, an exemption from supervisory sanctions or restrictions, or a limited growth exception.

Acceptable Capital Plan: Any savings association not in compliance with the capital standards shall have 60 days from promulgation of

the capital regulation (or 60 days from the date that the savings association falls out of compliance with the capital standards) to submit a capital plan to the District Director.* The District Director has delegated authority to approve or deny a capital plan.

The acceptance of a capital plan does not imply preapproval of contemplated actions or transactions for which a separate application or filing or prior notification is required. The acceptance of a capital plan represents that the Director of OTS, or his designee, has made a determination to permit the association to proceed with the proposed capital raising strategies in accordance with rules, regulations, and policy statements including application procedures. In certain limited circumstances, proposed activities or transactions may be approved as part of or in conjunction with a capital plan.

A capital-deficient savings association that files and adheres to a capital plan that is acceptable to the District Director (1) will be deemed to be in compliance with the statutory requirement that a capital-deficient savings association shall file a capital plan acceptable to the Director of OTS and (2) will be covered by the statutory provision that the Director of OTS shall, on or after January 1, 1991, require an association not in

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compliance with the capital standards to comply with a capital directive unless the association is granted an exemption from the capital directive in connection with the approval of a capital plan.

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 should specify the capital standard(s) established in Section 5(t) of the Home Owners' Loan Act, 12 U.S.C. 1464 (t) from which an exception is sought. The Director of OTS has sole authority to grant capital exceptions and such authority will be used only in extraordinary situations, and upon a compelling demonstration that the association will satisfy its applicable capital requirements by no later than December 31, 1990.

Neither a request for, or the granting of, a capital exception relieves a capital-deficient association of its obligation to comply with the statutory requirement that an association not in compliance with the capital requirements must file a capital plan acceptable to the Director of OTS.

Capital Exemption: A savings association may apply to the District Director for an exemption from a capital directive and other specific sanctions and penalties imposed upon the savings association for failure to comply with its minimum capital standards. The District Director has delegated authority to deny or approve a capital exemption request. Exemption requests are narrowly defined as requests for an exemption from specific sanctions and penalties, including a capital directive, that are imposed upon an association for failure to comply with its capital requirements. An association that operates in accor-

dance with an approved capital plan and exemption request will be deemed (1) to require more than normal supervision and (2) to be in compliance with the statutory requirement to file an acceptable capital plan. The approval of an exemption request will remain in effect through the period covered by the capital plan unless (1) the approval specifically states otherwise, (2) the exemption is subsequently revoked in accordance with the statutory provisions set forth under Section 5(t)(7)(c) of the HOLA or (3) the association fails to comply with an acceptable capital plan and the conditions of approval.

The savings association may only request and receive approval of specific, express exemptions in accordance with OTS rules, regulations and policy statements when the Director of OTS, or his designee, has explicit authority to grant such approvals. Approval of the capital plan or exemption request does not constitute an implicit approval of other exemption requests and related applications filed under other regulations and policy statements. Notwithstanding approval of a capital plan and exemption request, all asset growth restrictions shall remain in effect unless such approval specifically states otherwise.

Pursuant to Section 5(t)(7)(c), the Director of OTS may approve an application for an exemption or exception 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. This section provides that the Director of OTS shall deny an application for an exemption or exception and shall revoke any prior approval with respect to any such request if the Director of OTS, or his designee, determines that the association's failure to meet any capital requirement is accompanied by the following: (1) a pattern of consistent losses; (2) substantial dissipation of assets; (3) evidence of imprudent management or business behavior; (4) a material violation of any Federal law, any law of any State to which such association is subject, or any applicable regulation; (5) any other unsafe or unsound condition or activity, other than the failure to meet the capital standards.

Any application for an exemption must be accompanied by a capital plan acceptable to the District Director. Capital plans submitted without an express request for an exemption(s) will be evaluated on the assumption that an exemption from a capital directive was sought, and in such cases, a capital directive exemption will be granted if the applicable statutory criteria for an exemption are met. The general requirements, set forth in FIRREA, for any capital plan 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

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be accompanied by an increase in tangible capital not less in percentage amount than the average limit then applicable and

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

Limited Growth Exception: Prior to January 1, 1991, for an association not meeting all of its capital requirements, the District Director has discretionary authority to approve the association's request to increase its assets in an amount exceeding the amount of net interest credited to its deposit liabilities. A savings association that fails its minimum capital requirements shall not increase its assets unless the association receives the prior written approval of the District Director in connection with the approval of a capital plan. The association may not increase its assets in an amount exceeding the amount of net interest credited to its deposit liabilities without the prior approval, by the District Director, of a limited growth exception. The association's capital plan and limited growth exception request must be consistent with OTS policy as established in Regulatory Bulletin 3a-1 (Policy Statement on Growth for Savings Associations).

After December 31, 1990, the District Director does not have the authority to permit an association not in compliance with the capital standards to increase its assets in an amount that exceeds the amount of its net interest credited to its deposit liabilities. A savings association that fails the applicable capital standards *shall not* increase its assets unless it obtains prior 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.

Disclosure Requirements: An association is responsible for complying with the disclosure requirements established in OTS Legal Alert Memo No. 2. The memo outlines the elements of proper disclosure requirements by an association of its capital status in securities filings.

Procedures

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

As a general rule, the approval of 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 District Director has delegated authority to act upon any application filed with the capital plan; and (5) 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 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.

A capital plan will not be acceptable if the success of the plan is based upon the assumption that the association will receive government financial assistance (Open Bank Assistance). It is OTS policy that the success of a capital plan must not rely on proposed rules and regula-

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tions. To date, the Federal Deposit Insurance Corporation (FDIC) has not established a policy indicating that Open Bank Assistance is a realistic recapitalization strategy for eligible associations. The policy regarding Open Bank Assistance will be subject to change in the event that the FDIC establishes a program for granting such assistance in the future.

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 capital plan should:

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 initiated *no later than December 31, 1990*. For example, complete and identifiable steps to raise additional capital through a securities offering must be initiated before December 31, 1990; the offering need not be completed by that date. 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.

It is OTS policy that all savings associations shall attain compliance with the capital standards and the fully phased-in capital requirement (the capital standard to be applicable on December 31, 1994) as quickly as feasible for the association. This Bulletin does not give all associations until December 31, 1994 to comply with the capital standards, but only provides that a capital plan can be unacceptable if it does not demonstrate capital compliance by December 31, 1994. Accordingly, an association may be required to comply with all capital standards by a date that is determined to be reasonable by the District Director notwithstanding the fact that the date may precede December 31, 1994. Any capital plan that does not demonstrate, to the satisfaction of the District Director, that the association will meet all capital standards as soon as possible and within a reasonable period of time, as determined by the District Director, not to extend beyond 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 must 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. Provide *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. Provide *pro forma* financial statements regarding any contemplated transactions in accordance with generally accepted accounting principles (GAAP), except where modified by OTS capital regulations. The District Director may require an independent accounting opinion, if appropriate;

Provide *pro forma* consolidated and unconsolidated financial statements for the savings association prepared in accordance with GAAP, except where modified by OTS capital regulations. 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, loans-to-one borrower limitations, brokered deposits, and

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transactions with affiliates. Associations operating under existing forbearances or waivers must list all forbearances/waivers and provide a detailed analysis that sets forth the extent to which the association has operated in accordance with the forbearance/waiver authority including all activities and investments. Capital plans that are based upon the continuation of forbearances/waivers or approvals under superseded statutes or regulations regarding loans-to-one borrower, equity risk investments and transactions with affiliates will generally be unacceptable when the success of the plan is based upon the continuation of such forbearances/waivers. The basis for this policy is that capital-deficient associations should, as a matter of safety and soundness, rarely be permitted to exceed the limitations and restrictions on activities and investments established under uniformly applicable statutes, OTS regulations and policy statements;

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;
11. Describe in detail any 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; and

12. Demonstrate that all obligations set forth in existing capital maintenance agreements will be met as quickly as possible. In general, obligations must be met within 30 days following the date that the association fails to meet the capital requirements unless the agreement states otherwise. When an equity infusion cannot be made within the applicable time frame, the following steps must be taken by the association: (1) inform the District Director that the obligation under the agreement cannot be satisfied within the applicable time frame and (2) provide the District Director with a schedule for capital infusions in accordance with the obligations established in the capital maintenance agreement. All capital infusions must occur as soon as possible, but no later than December 31, 1990 (or 12 months following the date that the association fails to comply with the capital requirements). Controlling shareholders and companies should be advised that failure to fully comply with all applicable obligations in accordance with the provisions set forth in a capital maintenance agreement will result in enforcement action.

Conditions of Acceptance

The ability to prepare and successfully execute an acceptable plan is a capital-deficient 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

(IMCR) authority in accordance with Section 5(s) of the HOLA and 12 C.F.R. Section 567.3 in connection with the acceptance of any capital plan. The intent of the District Director to issue an IMCR will be communicated in accordance with Section 567.3 and will generally be communicated to the association during the capital plan process.

A capital plan that is dependent upon the success of a future transaction including, but not limited to, a proposed acquisition, merger, or stock offering, and that nevertheless, is deemed to be acceptable, may be approved subject to operating restrictions that will be effective prior to the event(s). Further, the approval will be contingent upon the association complying with all interim targets that support the final implementation of the future event(s). Generally, the acceptance of a plan of this type 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 or certify that the association will comply with the conditions/terms of the capital plan approval that 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 may 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

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assumptions. At a minimum, the capital plan shall be revised on an annual basis. [Note: The fact that an association may file an amendment to the capital plan does not constitute a waiver by the Director of OTS of the authority to take supervisory or enforcement action at any time following an event or circumstance that materially affects the validity of the plan or its underlying assumptions or causes the association to fail the interim operating and capital targets established in the capital plan.]

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 by a savings association to file such variance reports or to meet its interim capital targets as set forth in the capital plan will constitute an unsafe and unsound practice. Variances that the District Director deems to be material may be grounds for revoking approval of the capital plan, exception, or exemption.
4. 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 an 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. [Note: This condition shall not constitute a waiver by the Director of OTS, or his designee, of the authority to revoke the approval of a capital plan and related filings and impose operating restrictions on the association at any time following a failure by the association to meet the interim operating and capital targets established within the capital plan.]

5. 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 or enforcement action against the savings association for reasons other than failure to meet the capital standards if his findings indicate that the association is engaging in unsafe or unsound practices or operating in an unsafe or unsound condition, notwithstanding the fact that the savings association may be operating in accordance with an acceptable plan.
6. The acceptance of a capital plan also 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.

Filing Process and Time Frames

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 generally be acted upon within 50 days following the date that the plan is initially filed with the District Office. However, the failure of OTS to act on a capital plan within the established time frames will not constitute grounds upon which to initiate litigation against OTS or claim that a plan has been automatically approved.

Applications filed in connection with a capital plan that is subsequently denied will be deemed to be materially deficient and withdrawn when the related application is dependent upon the bases and components of the association's capital plan or the association's viability.

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 gen-

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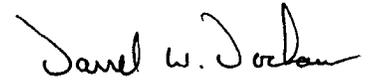
erally notify the savings association in writing whether the plan is acceptable. Failure by the savings association to respond to a request for additional information within 30 days will result in a rejection of the capital plan and related filing(s). Upon denial of the capital plan, the savings association will be subject to the full range of supervisory and enforcement actions.

The capital plan process is not subject to the provisions set forth in 12 C.F.R. Section 571.12 (Applications Processing Guidelines). The capital plan process is a statutory requirement relating to capital plan compliance and as such the nature of the filing and the process relate to the supervisory and enforcement authority of OTS. Filings that relate to enforcement and supervisory authority of the OTS were specifically excluded from the scope of the regulation to

ensure that OTS retains flexibility in exercising its enforcement and supervisory authority.

* 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.

RESCINDED



— Darrel W. Dochow
Senior Deputy Director, Supervision Operations