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# Defining ‘Unsafe or Unsound Practice’ and Revising the Framework for Issuing Matters Requiring Attention and Other Supervisory Communications: Interagency Notice of Proposed Rulemaking

To

Chief Executive Officers of All National Banks, Federal Savings Associations, and Federal Branches and Agencies; Department and Division Heads; All Examining Personnel; and Other Interested Parties

# Summary

The Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing to issue a joint notice of proposed rulemaking that would define the term "unsafe or unsound practice" for purposes of section 8 of the Federal Deposit Insurance Act (12 USC 1818) and revise the supervisory framework for the issuance of matters requiring attention (MRA) and other supervisory communications. The proposed rule is intended to promote greater clarity and certainty regarding certain enforcement and supervision standards and to ensure that these standards prioritize material financial risks.

Comments on all aspects of the proposed rule are due 60 days after it is published in the *Federal Register*.

## Note for Community Banks

The proposed rule would apply to all OCC-supervised institutions.

# Highlights

The proposed rule would

- establish a uniform definition for the term “unsafe or unsound practice” for the purposes of the agencies’ enforcement and supervisory authority under 12 USC 1818.
- define the term “unsafe or unsound practice” for purposes of 12 USC 1818 as a practice, act, or failure to act, alone or together with other practices, acts, or failures to act, that is contrary to generally accepted standards of prudent operation **and**
    - has materially harmed the financial condition of the institution **or**
    - if continued, is likely to
        - materially harm the financial condition of the institution **or**
        - present a material risk of loss to the Deposit Insurance Fund (DIF).
- establish uniform standards for when and how the agencies may communicate MRAs and nonbinding supervisory observations as part of the examination process.
- provide that the agencies may only issue an MRA for a practice, act, or failure to act, alone or together with one or more other practices, acts, or failures to act, that

    - is an actual violation of a banking or banking-related law or regulation **or**
    - is contrary to generally accepted standards of prudent operation **and**
        - has already caused material harm to the financial condition of the institution **or**
        - if continued, could reasonably be expected to, under current or reasonably foreseeable conditions
            - materially harm the financial condition of the institution **or**
            - present a material risk of loss to the DIF.
- clarify that the agencies may communicate other nonbinding suggestions to institutions orally or in writing to enhance an institution's policies, practices, condition, or operations as long as the communication is not, and is not treated by the agency in a manner similar to, an MRA.

# Background

The agencies exercise their enforcement and supervision authority to ensure that supervised institutions refrain from engaging in unsafe or unsound practices. To that effect, the agencies believe that it is important to promote greater clarity and certainty regarding certain enforcement and supervision standards by defining them by regulation. Moreover, the agencies believe that it is critical for

examiners and institutions to prioritize material financial risks over concerns related to policies, process, documentation, and other nonfinancial risks and that the agencies' enforcement and supervision standards further that prioritization.

There is currently no standard definition of the term "unsafe or unsound practice." The lack of a federal statutory definition for that term has resulted in enforcement actions and supervisory criticisms for concerns not related to material financial risks. The proposed regulatory definition would establish a consistent nationwide standard to provide greater clarity for institutions and institution-affiliated parties.

In addition, the agencies have different standards for when they may communicate an MRA. To ensure that supervision efforts are appropriately focused on material financial risks and to increase consistency in supervisory criticisms, the agencies are issuing this joint proposal regarding their standard for issuing MRAs.

# The Proposed Rule

The proposed rule would establish (1) a uniform definition for the term "unsafe or unsound practice" for purposes of the agencies' enforcement and supervisory authority under 12 USC 1818; (2) uniform standards for when and how the agencies may communicate MRAs and nonbinding supervisory observations as part of the examination process; and (3) tailoring of actions.

Unsafe or Unsound Practice

The proposed rule would define the term “unsafe or unsound practice” for purposes of 12 USC 1818 as a practice, act, or failure to act, alone or together with other practices, acts, or failures to act, that (1) is contrary to generally accepted standards of prudent operation; and (2) (i) if continued, is likely to (A) materially harm the financial condition of the institution; or (B) present a material risk of loss to the DIF; or (2)(ii) materially harmed the financial condition of the institution.

To qualify as an unsafe or unsound practice under the proposed definition, it would have to be likely—as opposed to, for example, merely possible—that the practice, act, or failure to act, if continued, would materially harm the financial condition of the institution or present a material risk of loss to the DIF. The agencies believe that including the term “if continued” is important to allow for identification of an unsafe or unsound act or failure to act before it impacts an institution’s financial condition. However, the conduct must be sufficiently proximate to a material harm to an institution’s financial condition to meet the proposed definition.

The proposed standard focuses on material harm to financial condition, and the agencies generally interpret harm to refer to financial losses. Therefore, to be an unsafe or unsound practice, a practice, act, or failure to act generally must have either caused actual material losses to the institution or must be likely to cause material

loss or other negative financial impacts to the institution. The standard would not include risks to the institution's reputation unrelated to financial condition.

An unsafe or unsound practice would also include a practice, act, or failure to act that, if continued, is likely to negatively affect an institution's ability to avoid FDIC receivership and presents a material risk of loss to the DIF as a result of the failure.

MRAs and Supervisory Observations

The proposed rule would create a uniform standard for examiners' communication of an MRA to supervised institutions. Specifically, the proposed rule provides that the agencies may only issue an MRA for a practice, act, or failure to act, alone or together with one or more other practices, acts, or failures to act, that (1) (i) is contrary to generally accepted standards of prudent operation; and (ii) (A) if continued, could reasonably be expected to, under current or reasonably foreseeable conditions; (I) materially harm the financial condition of the institution; or (II) present a material risk of loss to the DIF; or (B) has already caused material harm to the financial condition of the institution; or (2) is an actual violation of a banking or banking-related law or regulation. This uniform standard would narrow the scope of deficient practices that would be eligible for MRA issuance.

The proposal also clarifies that the agencies may communicate other nonbinding suggestions to institutions orally or in writing to enhance

an institution's policies, practices, condition, or operations as long as the communication is not, and is not treated by the agency in a manner similar to, an MRA (e.g., through tracking). This framework would allow examiners to share their expertise with management and the board of directors about potential enhancements while leaving decisions regarding the implementation of any enhancements to the institution.

Tailoring

The proposal requires tailoring of agency supervisory and enforcement actions, as well as MRA issuances, based on the capital structure, riskiness, complexity, activities, asset size, and any financial risk-related factor that the agencies deem appropriate. This includes tailoring with respect to the requirements or expectations set forth in such actions as well as whether, and the extent to which, such actions are taken. The same tailored standard would apply to practices, acts, or failures to act by institution-affiliated parties.

# Further Information

Please contact the Chief Counsel's Office at (202) 649-5490.

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# Related Link

- Unsafe or Unsound Practices, Matters Requiring Attention (PDF)

Topic(s): ENFORCEMENT ACTIONS · LAWS & REGULATIONS · OCC REGULATIONS · RISK-BASED SUPERVISION