



TEXAS DEPARTMENT OF BANKING

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SUPERVISORY MEMORANDUM – 1007

March 6, 2015 (rev.)

TO: All State-Chartered Banks, All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policies Regarding Investment Securities¹

Background

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), regulatory changes have been implemented regarding the permissibility of certain investment activities. The Office of the Comptroller of the Currency (OCC) adopted a final rule and related guidance which removes references to external credit ratings and clarifies regulatory expectations regarding assessing a security's creditworthiness and ongoing due diligence consistent with requirements in the Dodd-Frank Act. Under part 362 of the Federal Deposit Insurance Corporation's regulations, insured state banks generally are prohibited from engaging in an investment activity that is not permissible for a national bank under OCC regulations. Under the Federal Reserve Act (12 USC 335) and the Federal Reserve's Regulation H (12 CFR 208.21), state member banks may purchase, sell, underwrite, or hold securities and stock as national banks under the National Banking Act. State member and nonmember banks must comply with the OCC regulations when investing in securities.

This Supervisory Memorandum reinforces the Department's endorsement and adoption of federal banking agencies' policies relating to the investment security standards and activities, consistent with the Dodd-Frank Act. This Memorandum also establishes the Department's policy regarding the classification and appraisal of municipal bonds.

Policy

The investment guidance issued by the OCC and affirmed by the FDIC in Financial Institution Letter FIL-48-2012 and the Federal Reserve Board in SR letter 12-15, amends the definition of "investment grade" by removing references to external credit ratings and requires banks to make assessments of a security's creditworthiness to determine if it is "investment grade."² A security meets the "investment grade" regulatory standard for credit quality if the security has (1) low risk of default by the obligor, and (2) the full and timely repayment of principal and interest is expected over the life of the investment. Banks may continue to take into account external credit ratings and assessments as a valuable source of information; however, banks are expected to supplement these ratings with due diligence processes which consider the interest rate, credit, liquidity, price, size, complexity, and other risks presented by the investments. Additionally, ongoing analysis of the investment portfolio should continue to be performed to ensure that investments are appropriate for the bank's risk profile.

¹ This memorandum revises and supersedes the policy issued on August 21, 1998 and addresses recent federal rules and guidance issued as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

² For the OCC's final rules, see 77 FR 35253 (June 13, 2012), For the OCC's guidance, see 77 FR 35259 (June 13, 2012) and OCC Bulletin 2012-18 (June 26, 2012).

The Department concurs that state-chartered banks must comply with the federal regulations and guidance related to investment securities. The Department's policy regarding investment in municipal bonds, however, considers that if a bond is rated, it should be in the top four rating categories provided by Nationally Recognized Statistical Rating Organizations in order to be considered "investment grade." Per the federal guidance, independent credit analysis should still be performed by the bank on purchases of municipal revenue bonds. While it is not mandatory that general obligation bonds meeting the criteria for Type I bonds be subject to detailed credit analysis, an adequate level of credit review is still expected as a safe and sound banking practice. If a bond is not rated, the bank's supplemental analysis should validate why the bond is considered to be of "investment grade." Banks must perform both pre-acquisition and ongoing periodic post-acquisition analysis of securities held to support the "investment grade" nature of the bonds held.

The Department also concurs with the Uniform Agreement on the Classification and Appraisal of Securities Held by Financial Institutions which was updated by federal regulatory authorities on October 29, 2013.