

INITIAL EXAMINATION PROCEDURES

OVERVIEW

The following procedures are for examiner use in conducting those activities that commence upon entering a financial institution for a compliance/CRA examination. These procedures are required as part of the examination process.

Examination Objective(s)

The objectives of the initial examination activities are to:

- Provide specific guidance on fundamental examination tasks
- Help direct the focus of the examination
- Alert the examiner to potential problems or areas of concern

In This Section

TOPIC	SEE PAGE:
MEETING WITH EXAMINATION STAFF	A-2
COMPLIANCE DOCUMENT REQUEST	A-2
ENTRANCE MEETING WITH MANAGEMENT	A-2
MEETING MINUTES REVIEW	A-4
AUDIT REPORTS	A-5
LOAN POLICIES	A-8
OTHER POLICIES, FILES, AND PROGRAMS	A-11
COMMUNITY CONTACTS	A-13
REFERENCES	A-14

**MEETING
WITH
EXAMINATION
STAFF**

Meet with Examination Staff
Hold a meeting with the examination staff preceding the on-site review or the first day of the on-site examination. The Examiner-in-Charge (EIC) should discuss the following: <ul style="list-style-type: none">• Results of pre-examination planning (PEP)• Scope of the examination• Anticipated length of examination• Job assignments/tasks to be completed by each examiner• Work schedule• Planned or anticipated absences of examination staff during the examination, including: scheduled training; annual, sick, or credit (compensatory) leave

**COMPLIANCE
DOCUMENT
REQUEST**

Review Compliance Document Request Materials
1. Prior to the entrance meeting with management, review the materials requested on the Compliance Document Request (CDR) during PEP.
2. Identify any requested materials not provided so that they may be requested again of management.

**ENTRANCE
MEETING
WITH
MANAGEMENT**

Meet with Management
1. Schedule the entrance meeting with management during PEP. This meeting should take place as soon as possible after entering the financial institution to conduct the on-site portion of the examination.

**ENTRANCE
MEETING
WITH
MANAGEMENT
(cont'd)**

2. Ask that persons responsible for managing the daily operations of the financial institution attend.

These individuals may include:

- President and/or chief executive officer
- Compliance and Community Reinvestment Act (CRA) officer(s)
- Any other persons identified by the financial institution's management

3. Prepare an agenda for discussion that includes:

- An overview of the examination process
- The names of FDIC examiners and work schedule
- Anticipated length of the examination
- The EIC's accessibility throughout the on-site examination to discuss any issues or concerns relating to the examination or FDIC policy and practices in general
- The identity of the individual(s) who is/are the primary contact person(s) for examination related issues
- Work space requirements and access to the financial institution's files and personnel
- The issues identified during PEP (scope of the exam), including questions related to the materials forwarded to the field office in response to the Compliance Information Request (CIR)
- The materials requested during PEP as part of the CIR or the CDR which had not been provided by the financial institution
- An explanation of the FFIEC's Community Contacts Procedures
- An explanation of the closing management meeting procedures as outlined in the Closing Management and Board Meetings section of this manual
- Date of next board of directors/trustees meeting

Management should be advised that, depending upon the examination findings, the FDIC may need to attend the regularly scheduled meeting or call for a special board meeting.

- A confirmation that management will or will not request the FDIC to review investments and community services for CRA

**ENTRANCE
MEETING
WITH
MANAGEMENT
(cont'd)**

*NOTE: Small banks may receive an "Outstanding" without consideration of investments and community services; however, these areas will not be reviewed during the examination **unless** management requests the FDIC to do so. Investments and services can only be used to upgrade a "Satisfactory" to an "Outstanding" rating; they cannot downgrade a "Satisfactory" rating. Investments and services cannot be used to upgrade a "Needs to Improve" or a "Substantial Noncompliance" to a "Satisfactory" rating.*

**MEETING
MINUTES
REVIEW**

Review Official Minutes from Meetings
<p>1. Perform an expedient review of the official minutes from meetings of the financial institution's board of directors/trustees since the last examination. Also, review compliance, loan, and audit committee minutes as warranted.</p>
<p>2. Determine the following:</p> <ul style="list-style-type: none"> • Extent of board oversight/involvement in assuring compliance with consumer protection and fair lending laws and regulations (for example, the commission and review of internal and external audits) • Training of directors and senior management regarding consumer protection/fair lending issues • The board's rationale for implementing or modifying loan policies or other consumer compliance related policies or procedures • Records or indications of negative comments on rejected loan applications during loan committee or any other meeting • Any such records must be traced to the specific loan file to assure that no unlawful disparate treatment or discrimination in violation of the Equal Credit Opportunity or Fair Housing Acts was involved in the denial • Consideration of new loan or deposit products • Approval of, and rationale for, branch openings and closings

**AUDIT
REPORTS**

Review Internal/External Audit Reports

1. Review consumer compliance and fair lending audit reports generated by internal and external sources to ensure:
 - Scopes of audits are adequate
 - Identified weaknesses have been appropriately addressed

TIP: A determination that the scope and thoroughness of any internal or external review meets the purposes of FDIC examination procedures may allow for a limited scope of review in specific areas.

2. Use audit reports and other internal reviews to assess:
 - Effectiveness of the financial institution's policies, procedures, and practices
 - Extent to which staff complies with outstanding policies and procedures
 - Adequacy of staff training
 - Whether or not audit review procedures are comprehensive enough to allow for limited scope examinations

Exception: Do not request fair lending self-testing reports (or results). If, however, a financial institution voluntarily provides documentation of its fair lending self-testing, review the findings. Read the Self-Testing for Fair Lending Compliance section below for more information.

NOTE: A financial institution's audit or review of loan files, internal policies, and training material may indicate difference in the treatment of applicants that could constitute a violation of the fair lending laws.

3. Determine whether exceptions corrected by the financial institution will be included in the Report of Examination (ROE).

If internal/external audit reports indicate that identified exceptions have been corrected by the financial institution prior to the beginning of the compliance examination, use discretion in determining whether or not to include these exceptions in the ROE. If included, remarks should give the institution credit for corrections made.

Consider the following:
 - The nature of the identified exceptions

**AUDIT
REPORTS
(cont'd)**

<ul style="list-style-type: none"> • The circumstances of the occurrences and correction of these exceptions • Proximity (in terms of time) between the audit and the examination • Overall compliance posture of the financial institution
<p>4. Review corrective actions on problem areas cited during the compliance review to evaluate management's commitment to corrective actions. Consider the following:</p> <ul style="list-style-type: none"> • Nature of the identified exceptions • Circumstances surrounding the occurrence (i.e., cause, time period, etc.) and correction of these exceptions • Length of time between the audit and Compliance examination • Overall compliance posture of the financial institution
<p>5. Based on the review of information, determine if the internal/external audit function is sufficient to determine if the institution(s) is complying with consumer protection and fair lending laws and regulations.</p> <p>If a significant number of violations are noted at the current examination and were not detected by the internal/external compliance review, the examiner should complete a full scope examination. For financial institutions that are members of multi-bank holding companies, a recommendation would be made that the bank holding company's internal/external compliance review procedures cannot be used to limit or target the scope of a compliance examination for other member institutions.</p>
<p>6. Discuss with management at the exit meeting findings of the compliance reviews.</p>
<p>7. Include a discussion of audit reviews in the ROE on the Examiner's Comments and Conclusions page as shown in Part VII: B-1 of this manual.</p>

**Self-Testing for
Fair Lending
Compliance**

As previously stated, the FDIC encourages financial institutions to conduct internal reviews for compliance with consumer protection and fair lending laws and regulations.

The FDIC distinguishes between self-tests and internal reviews. A financial institution can use pre-application testing to uncover instances of prohibited discrimination against individuals protected under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA).

**AUDIT
REPORTS
(cont'd)**

**Self-Testing for
Fair Lending
Compliance
(cont'd)**

A **self-test** is defined as any program, practice, or study that:

- Is designed and used specifically to determine the extent or effectiveness of a creditor's compliance with the act or Regulation B; and
- Creates data or factual information that is not available and cannot be derived from loan or application files or other records related to credit transactions.

The report or results of a self-test that a creditor voluntarily conducts (or authorizes) are privileged only if the creditor has taken or is taking appropriate corrective action. Information that **is not** privileged includes:

- Information about whether a creditor conducted a self-test, the methodology used or the scope of the self-test, the time period covered by the self-test, or the dates it was conducted; or
- Loan and application files or other business records related to credit transactions, and information derived from such files and records, even if it has been aggregated, summarized, or reorganized to facilitate analysis.

Any evidence of discrimination voluntarily produced by a self-test will not be used against a creditor, provided the creditor takes appropriate corrective actions for any discrimination that is found.

Refer to Section 202.15 of Regulation B for complete rules governing self-tests.

Examiners are not to ask to review a financial institution's self-testing results. If, however, a financial institution voluntarily provides documentation of its self-testing efforts, the examiner should review the findings.

Procedures
If a financial institution voluntarily provides documentation of its fair lending self-testing, review the findings in accordance with Part III: H2-1 of this manual.

**Internal
Reviews for
Fair Lending
Compliance**

In an internal review or self-evaluation, the financial institution reviews information maintained in:

- Actual loan files
- Home Mortgage Disclosure Act loan application registers (HMDA-LARs)
- Policy manuals
- Training materials
- Audit reports



**AUDIT
REPORTS
(cont'd)**

Unlike self-testing, internal reviews or self-evaluations are based on information about actual loan applicants, and **should be requested during the examination.**

**Internal
Reviews for
Fair Lending
Compliance
(cont'd)**

**LOAN
POLICIES**

Prepare to Evaluate Loan Policies	
1.	<p>Determine, prior to the review of loan files, whether:</p> <ul style="list-style-type: none"> • Loan policies and procedures are sufficiently extensive to safeguard against violations of consumer protection and fair lending laws and regulations <p><i>NOTE: Loan policies may be formal (written) or informal (verbal).</i></p>
2.	<p>If informal:</p> <ul style="list-style-type: none"> • Obtain loan requirements and applicant qualifications, including any specific characteristics, through discussions with management and the lending staff • Review loan files and interview appropriate personnel to clarify or confirm loan information, particularly those issues relating to the fair lending portion of the examination
3.	<p>Evaluate the financial institution's loan policies in light of the questions listed below. Note the applicable or related laws and regulations referenced in the parenthesis.</p>
Relevant Questions	
	<ul style="list-style-type: none"> • Has the institution established any lending standards? (Equal Credit Opportunity Act [ECOA], Fair Housing Act [FHA]) • Are the loan underwriting standards/criteria specific and non-subjective? (ECOA, FHA) • Do any of the specific standards potentially exclude persons afforded protection under ECOA or FHA? (ECOA, FHA) • Do any of the specific credit standards potentially exclude minority applicants or neighborhoods? The following are examples of standards that, although neutral on their face, may have the effect of preventing, or discouraging, applications from minority applicants or applicants of minority neighborhoods: <ul style="list-style-type: none"> -- Minimum unit or building lot size

**LOAN
POLICIES
(cont'd)**

- Maximum property age
- Minimum property value or loan amount
- Minimum employment stability
- Past due credit limitations regarding duration and severity
- Debt-to-income ratios
- Loan-to-value ratios
- “Desirable” versus “undesirable” credits/borrowers
- Requirements for prior banking relationships
- Requirements for validating credit history (solely through a report from a credit reporting agency) (ECOA/FHA)

The lending standards noted above may also have an impact on an institution’s lending to low- and moderate-income applicants and neighborhoods. If the CRA review indicates that an institution has a small presence or weak penetration among low- and moderate-income applicants and/or neighborhoods, reviewing underwriting standards may help explain the low penetration.

- Under what circumstances does the financial institution **not require** a written loan application? (ECOA, FHA)
- If applicable, how would the financial institution adjust or “gross-up” non-taxable income, public assistance payments and some retirement income to determine qualifying income and debt ratios? (ECOA, FHA)
- How does the financial institution determine collateral value? Under what circumstances are appraisals ordered? (ECOA, FHA)
- What applicant characteristics prompt the institution to order a credit history from a credit reporting bureau? (ECOA, FHA, Fair Credit Reporting [FCR])
- How does the financial institution determine interest rates?
 - What flexibility or discretion does the lending officer have?
 - Does the institution have a policy that allows for overages?

NOTE: An overage is an amount of money charged to the borrower for a particular mortgage loan product in excess of a minimum base price. Typically, overages are split between the financial institution and the originator who obtained the overage.

- How does the institution monitor overages? (ECOA, FHA)
- Does the institution or the credit bureau(s) it uses assign risk ratings to applicants? (ECOA, FHA)

**LOAN
POLICIES
(cont'd)**

- What type of loan fees does the financial institution assess and in what circumstances? (ECOA, FHA, Real Estate Settlement Procedures [RESPA], Credit Practices Rule [CPR], Truth in Lending [TIL], Flood Insurance [FI])
- If adverse action on a loan application is recommended or taken, under what circumstances, if any, would applicants undergo a second review? (ECOA, FHA)
- What circumstances prompt foreclosure or repossession proceedings? Do the institution's policies reveal any potential for prohibited disparate treatment? (ECOA, FHA)
- Does the institution sell to or purchase loans from other business organizations (for example, loan brokers or car dealers)?
 - If so, does the financial institution make the final credit decision?
 - Does the financial institution establish or otherwise control the lending standards?
 - Is there a written agreement between the seller/buyer and the financial institution? (ECOA, FHA, CRA, Home Mortgage Disclosure Act [HMDA], CPR, Preservation of Consumers' Claims and Defenses [PCCD], RESPA)
- Under what circumstances does the financial institution require or request a co-signer or guarantor? (ECOA, CPR)
- What applicant characteristics would prompt the institution to offer or request the purchase of credit life insurance? (TIL, ECOA)
- Under what circumstances does the financial institution require or request the applicant to obtain other types of insurance (for example, hazard, flood, auto)? (TIL, RESPA, FI)
- Under what circumstances does the financial institution allow or make exceptions to its lending standards and policies? (ECOA, FHA)
- Who is/are responsible for preparing and reviewing consumer disclosures?
- Do the various loan departments within the financial institution accept applications or make loans that would normally be made by another loan department (for example, a commercial loan department making home purchase mortgages for customers as accommodation loans)?
- If separate loan policies are used for different types of loans, are requirements more stringent for those types of loans specifically geared to low- to moderate-individuals (for example, debt consolidation or first-time homebuyer loan programs)? If so, what impact do these stricter policies have on lending in low- to moderate-income or minority communities? (ECOA, FHA)

**OTHER
POLICIES,
FILES, AND
PROGRAMS**

Review Other Policies, Files, and Programs	
The following policies and files are requested in the CDR and will need to be reviewed.	
Appraisal Policy	
1.	Review appraisal policies prior to review of the loan files.
2.	Identify the circumstances when the financial institution requires: <ul style="list-style-type: none"> • An independent, professional appraisal • An in-house staff appraisal <p><i>NOTE: During the examination, review loan documents and adverse action notices to determine if the institution's appraisal policy is applied consistently.</i></p>
3.	Review the appraisal policy for possible indications of discrimination, including, but not limited to: <ul style="list-style-type: none"> • Neighborhoods the institution identifies or indicates are undesirable • Circumstances when appraisal fees are waived or refunded • Any unusual pattern or practice related to the choice of a specific outside fee appraiser, or the decision to rely on in-house personnel
Branch Closing Policy	
4.	Review the institution's branch closing policy to ensure it satisfies all the regulatory requirements found in Section 42 of the FDI Act. <i>Refer</i> to Branch Closing Policy Examination Procedures (Part III: G4-1).
Complaints File	
5.	Review copies of all consumer complaints filed against the financial institution since the previous examination to ensure that the institution has complied with all applicable consumer protection and civil rights laws and regulations. Contact the Consumer Affairs staff in the Regional Office to ensure access to all complaints.

**OTHER
 POLICIES,
 FILES, AND
 PROGRAMS
 (cont'd)**

Daily Statement of Condition	
6.	<p>Review the daily statement of condition as a tool to assess the financial institution's asset and deposit structure as of the date of examination.</p> <p><i>NOTE: The daily statement may also be referred to as "balance sheet," "statement of assets and liabilities," or "general ledger," depending upon local preference.</i></p>
7.	<p>Use the daily statement of condition to determine:</p> <ul style="list-style-type: none"> • Loan categories and relative relationships • Loan-to-deposit ratio (using net loans) • Loan-to-total asset ratio • Equity investments that may be targeted to community development <p><i>NOTE: Equity investments and investments in municipal bonds for CRA purposes must meet the definition of a "Qualified Investment" as described in 12 C.F.R. 345.12(s).</i></p> <ul style="list-style-type: none"> • Investments in municipal bond issues • Appraisal and loan origination fees • Advertising and marketing expenses
Public File	
8.	<p>Review the CRA public file to determine if the applicable information for the particular institution is included. Refer to Part IV: Community Reinvestment in this manual.</p>
Compliance Program	
9.	<p>Review the financial institution's compliance program and determine whether the program meets the minimum standards outlined in the Institution Compliance Programs Appendix of this manual.</p>
Computer System Defaults	
10.	<p>Request System Defaults</p> <p>It is recommended that a listing of (computer) system defaults be obtained from management to assist in the review of compliance with various regulations, including Regulation Z, Regulation CC, Regulation DD, etc.</p>

**OTHER
 POLICIES,
 FILES, AND
 PROGRAMS
 (cont'd)**

	<p>For example, such a listing could provide the examiner with information such as:</p> <ul style="list-style-type: none"> • Late fees are charged 15 days past the due date • Funds from U.S. Treasury checks are held 0 days • Interest calculations for deposit accounts are based on the average daily balance or daily balance method <p>The system defaults identified on this listing should be reviewed with actual policies, practices, disclosures, etc.</p>
	<p>11. For the review of compliance with the Truth in Savings Act (TISA), determine if the institution calculates interest on the collected balance (as indicated by management on the CIR), request the required documentation from the TISA examination procedures during the initial stages of the examination.</p>

**COMMUNITY
 CONTACTS**

Community Contacts	
	<p>Conduct community contact interviews with community members or organizations early in the examination process.</p> <p>Where feasible, schedule contacts during PEP. This early contact will facilitate the interview process. Conducting the interview during the initial stages of the examination allows time to follow-up, when necessary, on information obtained from the community contacts.</p> <p><i>Refer to PART IV: F-1 of this manual for Community Contacts procedures Guidance.</i></p>
	<p>TIP: Previous community contacts conducted by the FDIC and other agencies are maintained in the FDIC's Community Contact Database accessed through the FDIC's Intranet. Identify actual and potential contacts by conducting a search of the database by the desired field. The Community Affairs staff in the Regional Office can also provide assistance in locating potential contacts.</p>



**FDIC LAW,
REGULATIONS,
& RELATED
ACTS**

Applicable Rules

Fair Credit Reporting Act, Volume 2, Page 6601

Federal Trade Commission Regulations: Statement of General Policy or Interpretation of the Fair Credit Reporting Act, Volume 2, Page 7179

Part 338–Fair Housing, Volume 1, Page 2647

Part 339–Loans in Areas Having Special Flood Hazards, Volume 1, Page 2663

Part 345–Community Reinvestment Act, Volume 1, Page 2781

Part 3500–Real Estate Settlement Procedures Act, Volume 3, Page 8891

Regulation B Part 202–Equal Credit Opportunity, Volume 2, Page 7209

Regulation C Part 203–Home Mortgage Disclosure, Volume 3, Page 7553

Regulation DD Part 230–Truth in Savings, Volume 2, Page 7429

Regulation Z–Truth in Lending, Volume 2, Page 6641

Section 42, Notice of Branch Closure, FDI Act, Volume 1, Page 1501

Staff Guidelines on the Credit Practices Rule, Volume 3, Page 7875

**Advisory
Opinions**

None

**Statements of
Policy**

Policy Statement of Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision Concerning Branch Closing Notices and Policies, Volume 2, page 5391



**DCA
MEMORANDA**

Internal/External Audit Function Review, Transmittal #97-014, dated 07/14/97,
Classification #6391

**FINANCIAL
INSTITUTION
LETTERS (FIL)**

Interagency Policy Statement on Branch Closings, Letter #65-99, dated 6/29/99. ■

OTHER

FFIEC Community Contacts Procedures, Community Reinvestment Act
Examination Procedures-and-Performance Evaluations, "Red Book", Tab K
