LAWS AND REGULATIONS CHAPTER 24

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INTRODUCTION

This section contains statutatory requirements applicable to information systems examinations.

Bank Service Corporation Act

(Public Law 87-856, October 23, 1962 as amended)
Title 12, U.S. Code, Sec. 1861 et seq.
Chapter 18 – Bank Service Corporations

Sec. 1861(1)[1] Short Title and Definitions

(a) This chapter may be cited as the "Bank Service Corporation Act".

(b) For the purpose of this Act-

(1) the term "appropriate Federal Banking agency" shall have the meaning provided in section 1813(q) of this title;

(2) the term "bank service corporation" means a corporation organized to perform service authorized by this chapter, all of the capital stock of which is owned by one or more insured banks;

(3) the term "Board" means the Board of Governors of the Federal Reserve System;

(4) the term "depository institution" means an insured bank, a financial institution subject to examination by the Federal Home Loan Bank Board or the National Credit Union Administration Board, or a financial institution the accounts or deposits of which are insured or guaranteed under State law and are eligible to be insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or the National Credit Union Administration Board;

(5) the term "insured bank" shall have the meaning provided in section 1813(h) of this title;

(6) the term "invest" includes any advance of funds to a bank service corporation, whether by the purchase of stock, the making of a loan, or otherwise, except a payment for rent earned, goods sold and delivered, or services rendered prior to the making of such payment; and

[1] Numbers in parentheses in this section refer to section numbers in the Bank Service Corporation Act.

(7) the term "principal investor" means the insured bank that has the largest dollar amount invested in the capital stock of a bank service corporation. In any case where two or more insured banks have equal dollar amounts invested in a bank service corporation, the corporation shall prior to commencing operations, select one of the insured banks as its principal investor and shall notify the bank's appropriate Federal banking agency of that choice within 5 business days of its selection.

Sec. 1862(2) Amount of Investment in Bank Service Corporation

Notwithstanding any limitation or prohibition otherwise imposed by any provision of law exclusively relating to banks, an insured bank may invest not more than 10 per centum of paid-in and unimpaired capital and unimpaired surplus in a bank service corporation. No insured bank shall invest more than 5 per centum of its total assets in bank service corporations.

Sec. 1863(3) Permissible Bank Service Corporation Activities for Depository Institutions (Perry Institutions)

Without regard to the provisions of sections 1864 and 1865 of this title, an insured bank may invest in a bank service corporation that performs, and a bank service corporation may perform, the following services only for depository institutions: check and deposit sorting and posting, computation and posting of interest and other credit and charges, preparation and mailing of checks, statements, notices, and similar items or any other clerical, bookkeeping, accounting, statistical, or similar functions performed for a depositor institution.

Sec. 1864(4) Permissible Bank Service Corporation Activities for Other Persons

(a) Services permissible other than taking deposits
A bank service corporation may provide to any person any service authorized by this section, except that a bank service corporation shall not take deposits.

(b) Services to be performed in State where shareholders are located

Except with the prior approval of the Board under section 1865(b) of this title in accordance with subsection (f) of this section –

(1) a bank service corporation shall not perform the services authorized by this section in any State other than that State in which its shareholders are located; and

(2) all insured bank shareholders of a bank service corporation shall be located in the same State.

(c) Performance where State bank is shareholder

A bank service corporation in which a State bank is a shareholder shall perform only those services that such State bank shareholder is authorized to perform under the law of the State in which such State bank operates and shall perform such services only at locations in the State in which such State bank shareholder could be authorized to perform such services.

(d) Performance where national bank is shareholder

A bank service corporation in which a national bank is a shareholder shall perform only those services that such national bank shareholder is authorized to perform under the law of the United States and shall perform such services only at location in the State at which such national bank shareholder could be authorized to perform such services.

(e) Performance where State bank and national bank are shareholders

A bank service corporation that has both national bank and State bank shareholders shall perform only those services that may lawfully be performed by both its national bank shareholder or shareholders under the law of the United States and its State bank shareholder or shareholders under the law of the State in which such State bank or banks operate and shall perform such services only at location in the State at which both its State bank and national bank shareholders could be authorized to perform such services.

(f) Geographic location

Notwithstanding the other provisions of this section or any other provision of law, other than the provisions of Federal and State branching law

regulating the geographic location of banks to the extent that those laws are applicable to an activity authorized by this subsection, a bank service corporation may perform at any geographic location any service, other than deposit taking, that the Board has determined, by regulation, to be permissible for a bank holding company under section 1843(c)(8) of this title.

Sec. 1865(5) Prior Approval for Investments in Bank Service Corporations

(a) Approval of Federal banking agency

No insured bank shall invest in the capital stock of a bank service corporation that performs any service under authority of subsection (c), (d), or (e) of section 1864 of this title without the prior approval of the bank's appropriate Federal banking agency.

(b) Approval of Board

No insured bank shall invest in the capital stock of a bank service corporation that performs any service under authority of section 1864(f) of this title and no bank service corporation shall perform any activity under section 1864(f) of this title without the prior approval of the Board.

(c) Considerations in determining approval

In determining whether to approve or deny any application for prior approval under this section, the Board or the appropriate Federal banking agency, as the case may be, is authorized to consider the financial and managerial resources and future prospects of the bank or banks and bank service corporation involved, including the financial capability of the bank to make a proposed investment under this chapter, and possible adverse effects such as undue concentration of resources, unfair or decreased competition, conflicts, of interest, or unsafe or unsound banking practices.

(d) Failure to act on application for approval

In the event the Board or the appropriate Federal banking agency, as the case may be, fails to act on any application under this section within ninety days of the submission of a complete application to the agency, the application shall be deemed approved.

Sec. 1866(6) Services to Nonstockholders

No bank service corporation shall unreasonably discriminate in the provision of any services authorized under this chapter to any depository institution that does not own stock in the service corporation on the basis of fact that the nonstockholding institution is in competition with an institution that owns stock in the bank service corporation, except that-

(1) it shall not be considered unreasonable discrimination for a bank service corporation to provide services to a nonstockholding institution only at a price that fully reflects all of the costs of offering those services, including the cost of capital and a reasonable return thereon; and

(2) a bank service corporation may refuse to provide services to a nonstockholding institution if comparable services are available from another source at competitive overall costs, or if the providing or services would be beyond the practical capacity of the service corporation.

Sec. 1867(7) Regulation and Examination of Bank Service Corporations

(a) Principal investor

A bank service corporation shall be subject to examination and regulation by the appropriate Federal banking agency of its principal investor to the same extent as its principal investor. The appropriate Federal banking agency of the principal shareholder of such a bank service corporation may authorize any other Federal banking agency that supervises any other shareholder of the bank service corporation to make such an examination

(b) Applicability of section 1818 of this title

A bank service corporation shall be subject to the provisions of section 1818 of this title as if the bank service corporation were an insured bank. For this purpose, the appropriate Federal banking agency shall be the appropriate Federal banking agency of the principal investor of the bank service corporation.

(c) Services performed by contract or otherwise

Notwithstanding subsection (a) of this section, whenever a bank that is regularly examined by an appropriate Federal banking agency, or any subsidiary or affiliate of such a bank that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises-

(1) such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself on its own premises, and

(2) the bank shall notify such agency of the existence of the service relationship within thirty days after the making of such service contract or the performance of the service, whichever occurs first.

(d) Issuance of regulations and orders

The Board and the appropriate Federal banking agencies are authorized to issue such regulations and orders as may be necessary to enable them to administer and to carry out the purposes of this chapter and to prevent evasion thereof.

Bank Holding Companies

Regulation Y
(as amended February 12, 1990)

Subpart C – Nonbanking Activities and Acquisitions by Bank Holding Companies.

12 CFR 225.22 Exempt Nonbanking Activities and Acquisitions.

(a) Servicing activities. A bank holding company may, without the Board's prior approval under this subpart, furnish services to or perform services for, or establish or acquire a company that engages solely in furnishing services to or performing services for:

(1) The bank holding company or its subsidiaries in connection with their activities as authorized by law, including services that are necessary to fulfill commitments entered into by the subsidiaries with third parties, if the bank holding company or servicing company complies with the Board's published interpretations and does not act as principal in dealing with third parties; and

(2) The internal operations of the bank holding company or its subsidiaries. Services for the internal operations of the bank holding company or its subsidiaries include, but are not limited to: (i) accounting, auditing, and appraising; (ii) advertising and public relations; (iii) data processing and data transmission services, data bases or facilities; (iv) personnel services (v) courier services; (vi) holding or operating property used wholly or substantially by a subsidiary in its operations or for its future use; (vii) liquidating property acquired from a subsidiary; (viii) liquidating property acquired from any sources either prior to May 9, 1956, or the date on which the company became a bank holding company, whichever is later; and (ix) selling, purchasing, or underwriting insurance such as blanket bond insurance, group insurance for employees and property and casualty insurance. ...

Financial Institutions Reform, Recovery, and Enforcement Act of 1989

Title II - FDIC (12 USC 1811 et seq.)

Sec. 225. Contracts Between Depository Institutions and Persons Providing Goods, Products, or Services

The Federal Deposit Insurance Act (12 USC 1811 et seq.) is amended by inserting after section 29 (as added by section 224 of this title) the following new section:

"Sec. 30. Contract Between Depository Institutions And Persons Providing Goods, Products, Or Services.

"(a) IN GENERAL. – An insured depository institution may not enter into a written or oral contract with any person to provide goods, products, or services to or for the benefit of such

depository institution if the performance of such contract would adversely affect the safety or soundness of the institution.

"(b) RULEMAKING. – The Corporation shall prescribe such regulations and issue such orders, including definitions consistent with this section, as many be necessary to administer and carry out the purposes of, and prevent evasions of, this section.

"(c) ENFORCEMENT. – Any action taken by any appropriate Federal banking agency under section 8 to enforce compliance on the part of any insured depository institution with the requirements of this section may include a requirement that such institution properly reflect the transaction on its books and records.

"(d) NO PRIVATE RIGHT OF ACTION. – This section may not be construed as creating any private right of action.

"(e) STUDY. –

"(1) IN GENERAL. – The Attorney General and the Comptroller General of the United States shall jointly conduct a study on the extent to which –

"(A) insured depository institutions are entering into contracts with vendors under which vendors agree to purchase stock or assets from insured depository institutions or to invest capital in or make deposits in such institutions; and

"(B) if such practices occur, the extent to which such practices are having an anticompetitive effect and should be prohibited.

"(2) REPORT TO CONGRESS. – Before the end of the 1-year period beginning on the date of the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Attorney General and the Comptroller General shall submit a report to the Congress on the results of the study conducted pursuant to paragraph (1)."

FDIC Improvement Act of 1991

On December 19, 1991, the FDIC Improvement Act (FDICIA) was signed into law, creating major changes in the regulation and supervision of insured depository institutions. Section 112 of FDICIA, entitled "Independent Annual Audits of Insured Depository Institutions" added section 36 to the Federal Deposit Insurance (FDI) Act. It established new audit, reporting, and audit committee requirements for certain insured depository institutions. FDIC regulation Part 363 implemented the new statutory requirements contained in section 36 of the FDI Act. Amendments to Part 363, adopted February 6, 1996 and became effective for fiscal years ending after March 31, 1996 are included.

Part 363 – Annual Independent Audits and Reporting Requirements

Sec.
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Appendix A to Part 363 – Guidelines and Interpretations

Authority: 12 USC 1831m.

Source: The provisions of this Part 363 appear at 58 Fed. Reg. 31335, June 2, 1993, effective July 2, 1993, and 61 Fed. Reg 6493, February 21, 1996 effective April 1, 1996..

363.0 OMB control number.

The collecting of information requirements in this part have been approved by the Office of Management and Budget under OMB control number 3064-0113.

363.1 Scope.

(a) *Applicability*. This part applies with respect to fiscal years of insured depository institutions which begin after December 31, 1992. This part does not

apply with respect to any fiscal year of any insured depository institution, the total assets of which, at the beginning of such fiscal year, are less than $500 million.

(b) *Compliance by subsidiaries of holding companies.*

(1) The audited financial statements requirement of Section 363.2(a) may be satisfied for an insured depository institution that is a subsidiary of a holding company by audited financial statements of the consolidated holding company.

(2) The other requirements of this part for an insured depository institution that is a subsidiary of a holding company may be satisfied by the holding company if:

(i) The services and functions comparable to those required of the insured depository institution by this part are provided at the holding company level; and

(ii) The insured depository institution has as of the beginning of its fiscal year:

(A) Total assets of less than $5 billion; or

(B) Total assets of $5 billion or more and a composite CAMEL rating of 1 or 2.

(3) The appropriate federal banking agency may revoke the exception in paragraph (b)(2) of this section for any institution with total assets in excess of $9 billion for any period of time during which the appropriate federal banking agency determines that the institution's exemption would create a significant risk to the affected deposit insurance fund.

363.2 Annual reporting requirements.

(a) *Audited financial statements.* Each insured depository institution shall prepare annual financial statements in accordance with generally accepted accounting principles which shall be audited by an independent public accountant.

(b) *Management report.* Each insured depository institution annually shall prepare, as of the end of the institution's most recent fiscal year, a management report signed by its chief executive officer and chief accounting or chief financial officer which contains:

(1) A statement of management's responsibilities for preparing the institution's annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with laws and regulations relating to safety and soundness which are designated by the FDIC and the appropriate federal banking agency; and

(2) Assessments by management of the effectiveness of such internal control structure and procedures as of the end of such fiscal year and the institution's compliance with such laws and regulations during such fiscal year.

363.3 Independent public accountant.

(a) *Annual audit of financial statement.* Each insured depository institution shall engage an independent public accountant to audit and report on its annual financial statements in accordance with generally accepted auditing standards and section 37 of the Federal Deposit Insurance Act (12 USC 1831n). The scope of the audit engagement shall be sufficient to permit such accountant to determine and report whether the financial statements are presented fairly and in accordance with generally accepted accounting principles.

(b) *Additional reports.* Such independent public accountant shall examine, attest to, and report separately on, the assertions of management concerning the institution's internal control structure and procedures for financial reporting. The accountant shall apply procedures agreed upon by the FDIC objectively to determine compliance by an insured depository institution with designated laws and regulations. The attestations shall be made in accordance with generally accepted standards for attestation engagements.

(c) *Notice by accountant of termination of services.* An independent public accountant performing an audit under this part who ceases to be the accountant for an insured depository institution shall notify the FDIC and the appropriate federal banking agency in writing of such termination within 15 days after the occurrence of such

event, and set forth in reasonable detail the reasons for such termination.

363.4 Filing and notice requirements.

(a) *Annual reporting.* Within 90 days after the end of its fiscal year, each insured depository institution shall file with each of the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor, two copies of:

(1) An annual report containing audited annual financial statements, the independent public accountant's report thereon, management's statements and assessments, and the independent public accountant's attestation report concerning the institution's internal control structure and procedures for financial reporting as required by Sections 363.2(a) and 363.3(a), 363.2(b), and 363.3(b) respectively; and

(2) The accountant's attestation concerning compliance with laws and regulations pursuant to Section 363.3(b).

(b) *Public availability.* The annual report in paragraph (a)(1) of this section shall be available for public inspection.

(c) *Independent accountant's reports.* Each insured depository institution shall file with the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor, a copy of any management letter, qualification, or other report issued by its independent public accountant with respect to such institution and the services provided by such accountant pursuant to this part within 15 days after receipt.

(d) *Notice of engagement or change of accountants.* Each insured depository institution shall provide, within 15 days after the occurrence of any such event, written notice to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor of the engagement of an independent public accountant, or the resignation or dismissal of the independent public accountant previously engaged. The notice shall include a statement of the reasons for any such event in reasonable detail.

363.5 Audit committees.

(a) *Composition and duties.* Each insured depository institution shall establish an independent audit committee of its board of directors, the members of which shall be outside directors who are independent of management of the institution, and the duties of which shall include reviewing with management and the independent public accountant the basis for the reports issued under this part.

(b) *Committees of large institutions.* The audit committee of any insured depository institution that has total assets of more than $3 billion, measured as of the beginning of each fiscal year, shall include members with banking or related financial management expertise, have access to its own outside counsel, and not include any large customers of the institution. If a large institution is a subsidiary of a holding company and relies on the audit committee of the holding company to comply with this rule, the holding company audit committee shall not include any members who are large customers of the subsidiary institution.

Appendix A to Part 363 – Guidelines and Interpretations

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Introduction

Congress added section 36, "Early Identification of Needed Improvements in Financial Management" (section 36), to the Federal Deposit Insurance Act (FDI Act) as part of the Federal Deposit Insurance Improvement Act of 1991, which became law on December 19, 1991.

The FDIC adopted 12 CFR Part 363 of its rules and regulations (this part), effective July 2, 1993, to implement those provisions of section 36 that require rulemaking. Simultaneously, the FDIC Board of Directors approved these "Guidelines and Interpretations" (the Guidelines) and directed that they be published as an appendix to this part to facilitate a better understanding of, and full compliance with, the provisions of section 36.

The Guidelines were developed by the FDIC, in consultation with the other appropriate federal banking agencies, after careful consideration of the comments received on the proposed rule.

Although not contained in this part, some of the guidance offered restates or refers to statutory requirements of section 36 and is therefore mandatory. If that is the case, the statutory provision is cited. The FDIC continues to believe, as stated in its "Statement of Policy Regarding Independent External Auditing Programs of State Nonmember Banks" (Nov. 16, 1988), that every insured depository institution, regardless of its size or charter, should have an annual audit of its financial statements performed by an independent public accountant, and should establish an audit committee comprised entirely of outside directors.

The following Guidelines reflect the views of the FDIC concerning the interpretation of section 36. The Guidelines are intended to assist insured depository institutions (institutions), their boards of directors, and their advisors, including their independent public accountants and legal counsel, and to clarify section 36 and this part. It is recognized that reliance on the Guidelines may result in compliance with section 36 and this part which may vary from institution to institution. Terms which are not explained in the Guidelines have the meanings given them in this part, the FDI Act or professional accounting and auditing literature.

Scope of Rule (363.1)

1. *Measuring Total Assets.* To determine whether this part applies, an institution should use total assets as reported on its most recent Report of Condition (Call Report) or Thrift Financial Report (TFR), the date of which coincides with the end of its preceding fiscal year. If its fiscal year ends on a date other than the end of a calendar quarter, it should use its Call Report or TFR for the quarter end immediately preceding the end of its fiscal year.

2. *Insured Branches of Foreign Banks.* Unlike other institutions, insured branches of foreign banks are not separately incorporated or capitalized. To determine whether this part applies, an insured branch should measure claims on non-related parties reported on its Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (form FFIEC 002).

3. *Compliance by Holding Company Subsidiaries.* Audited consolidated financial statements and other reports or notices required by this part which are submitted by a holding company for any subsidiary institution, should be

accompanied by a cover letter identifying all subsidiary institutions to which they pertain. An institution filing holding company consolidated financial statements as permitted by Section 363.1(b) also may report on changes in its independent public accountant on a holding company basis. An institution that does not meet the criteria in section 36(i) must satisfy the remaining provisions of the statute and this part on an individual institution basis, and maintain its own audit committee. Multi-tiered holding companies may satisfy all requirements of this part at any level.

4. *Comparable Services and Functions.* Services and functions will be considered "comparable" to those required by this part if the holding company:

   (a) Prepares reports used by the subsidiary institution to meet the requirements of this part;

   (b) Has an audit committee that meets the requirements of this part appropriate to its largest subsidiary institution; and

   (c) Prepares and submits the management assessments of the effectiveness of the internal control structure and procedures for financial reporting (internal controls), and compliance with the Designated Laws defined in guideline 12 based on information concerning the relevant activities and operations of those subsidiary institutions within the scope of the rule.

Annual Reporting Requirements (363.2)

5. *Annual Financial Statements.* Each institution should prepare comparative annual consolidated financial statements (balance sheets, statements of income, changes in equity capital, and cash flows, with accompanying footnote disclosures) in accordance with generally accepted accounting principles (GAAP) for each of its two most recent fiscal years. Statements for the earlier year may be presented on an unaudited basis if the institution was not subject to this part for that year and audited statements were not prepared.

6. *Holding Company Statements.* Subsidiary institutions may file copies of their holding company's audited financial statements filed with the Securities and Exchange Commission (SEC) or prepared for their FR Y-6 Annual Report under the Bank Holding Company Act of 1956.

7. *Insured Branches of Foreign Banks.* An insured branch of a foreign bank should satisfy the financial statements /requirement by filing one of the following for the two preceding fiscal years:

   (a) Audited balance sheets, disclosing information about financial instruments with off-balance-sheet risk;

   (b) Schedules RAL and L of form FFIEC 002, prepared and audited on the basis of the instructions for its preparation; or

   (c) With written approval of the appropriate federal banking agency, consolidated financial statements of the parent bank.

8. *Management Report.* Management should perform its own investigation and review of the effectiveness of internal controls and compliance with the Designated Laws defined in guideline 12. Management also should maintain records of its determinations and assessments until the next federal safety and soundness examination, or such later date as specified by the FDIC or appropriate federal banking agency. Management should provide in its assessment of the effectiveness of internal controls and compliance with the Designated

Laws, or supplementally, sufficient information to enable the accountant to report on its assertions. The management report of an insured branch of a foreign bank should be signed by the branch's managing official if the branch does not have a chief executive or financial officer.

9. *Safeguarding of Assets.* "Safeguarding of assets", as the term relates to internal control policies and procedures regarding financial reporting, and which has precedent in accounting literature, should be encompassed in the management report and the independent public accountant's attestation discussed in guideline 18. Testing the existence of and compliance with internal controls on the management of assets, including loan underwriting and documentation,

represents a reasonable implementation of section 36. The FDIC expects such internal controls to be encompassed by the assertion in the management report, but the term "safeguarding of assets" need not be specifically stated. The FDIC does not require the accountant to attest to the adequacy of safeguards, but does require the accountant to determine whether safeguarding policies exist.[2]

10. *Standards for Internal Controls.*[3] Each institution should determine its own standards for establishing, maintaining and assessing the effectiveness of its internal controls.

11. *Service Organizations.* Although service organizations should be considered in determining if internal controls are adequate, an institution's independent public accountant, its management, and its audit committee should exercise independent judgment concerning that determination. Onsite reviews of service organizations may not be necessary to prepare the reports required by the Rule, and the FDIC does not intend that the Rule establish any such requirement.

12. *Compliance with Laws and Regulations.* The designated laws and regulations are the federal laws and regulations concerning loans to insiders and the federal and state laws and regulations concerning dividend restrictions, which are more specifically identified in section 1 of the Agreed Upon Procedures referred to in guideline 19 (the Designated Laws).

Role of Independent Public Accountant (363.3)

13. *General Qualifications.* To provide audit and attest services to insured depository institutions, an independent public accountant should be registered or licensed to practice as a public accountant, and be in good standing, under the laws of the state or other political subdivision of the United States in which the home office of the institution (or the insured branch of a foreign bank) is located. As required by section 36(g)3(A)(i), the accountant must agree to provide copies of any work papers, policies, and procedures relating to services performed under this part.

14. *Independence.* The independent public accountant also should be in compliance with the AICPA's Code of Professional Conduct and meet the independence requirements and interpretations of the SEC and its staff.

15. *Peer Reviews.* As required by section 36(g)3(A)(ii), the independent public accountant must have received, or be enrolled in, a peer review that meets acceptable guidelines. The following peer review guidelines are acceptable:

    (a) The external peer review should be conducted by an organization independent of the accountant or firm being reviewed, as frequently as is consistent with professional accounting practices;

    (b) The peer review should be generally consistent with AICPA standards;[4] and

    (c) The review should include, if available, at least one audit on an insured depository institution or consolidated financial holding company. Peer review working papers are to be retained for 120 days after the peer review report is filed with the FDIC, and be made available to the FDIC upon request, in a form consistent with the SEC's agreement with the accounting profession.

16. *Filing Peer Review Reports.* Within 15 days of receiving notification that the peer review has

[2] It is management's responsibility to establish policies concerning underwriting and asset management and to make credit decisions. The auditor's role is to test compliance with management's policies relating to financial reporting.

[3] In considering what information is needed on safeguarding of assets and standards for internal controls, management may review guidelines provided by its primary federal regulator; the Federal Financial Institutions Examination Council's "Supervisory Policy Statement on Securities Activities"; the FDIC's "Statement of Policy Providing Guidance on External Auditing Procedure for State Nonmember Banks" (Jan. 16, 1990), "Statement of Policy Regarding Independent External Auditing Programs of State Nonmember Banks" (Nov. 16, 1988), and Division of Supervision Manual of Examination Policies; the Federal Reserve Board's Commercial Bank Examination Manual and other relevant regulations; the Office of Thrift Supervision's Thrift Activities Handbook; the Comptroller of the Currency's Handbook for National Bank Examiners; standards published by professional accounting organizations, such as the American Institute of Certified Public Accountant's (AICPA) Statement of Auditing Standards No. 55, "Consideration of the Internal Control Structure in a Financial Statement Audit"; the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Internal Control-Integrated Framework, including its addendum on safeguarding of assets; and other internal control standards published by the AICPA, other accounting or auditing professional associations, and financial institution trade associations.

[4] These would include Standards for Performing and Reporting on Peer Reviews, codified in the *SEC Practice Section Reference Manual*, and Standards for Performing and Reporting on Quality Reviews, contained in Volume 2 of the AICPA's *Professional Standards.*

been accepted, or before commencing any audit under this part, whichever is earlier, two copies of the peer review report, accompanied by any letter of comments and letter of response, should be filed by the independent public accountant with the FDIC, Registration and Disclosure Section, 550 17th Street N.W., Washington, D.C. 20429, where they will be available for public inspection. Accountants may elect to file an annual list of their insured depository institution and holding company (identifying any subsidiary institutions subject to this part) audit clients in lieu of copies of peer review reports for each institution they have been engaged to audit. The FDIC has determined that such client lists are exempt from public disclosure. All corrective action required under any qualified peer review report should have been taken prior to commencing services under this part.

17. *Information to Independent Public Accountant.* Attention is directed to section 36(h) which requires institutions to provide specified information to their accountants. An institution also should provide its accountant with copies of any notice that the institution's capital category is being changed or reclassified under section 38 of the FDI Act, and any correspondence from the appropriate federal banking agency concerning compliance with this part.

18. *Attestation Reports.* The independent public accountant should provide the institution with an internal controls attestation report, a compliance with Designated Laws attestation report, and any management letter, at the conclusion of the audit as required by section 36(c)(1). If a holding company subsidiary relies on its holding company management report, the accountant may attest to and report on the management's assertions in one report, without reporting separately on each subsidiary covered by this part. One attestation report for compliance with the designated laws also may be filed, if all exceptions are listed and the respective institutions to which the exceptions apply are identified. The FDIC has determined that management letters and the Designated Laws attestation report are exempt from public disclosure.

19. *Procedures for Determining Compliance with Designated Laws.* In order to permit the independent public accountant to determine the extent of compliance with the Designated Laws defined in guideline 12 and the related assessment by management, the procedures set forth in schedule A (the Agreed Upon Procedures) to these Guidelines in this appendix should be applied. The accountant should require all management representations to be in writing, and take appropriate steps to determine that any sampling is reasonably representative. Attestation reports generally should identify all findings from application of the Agreed Upon Procedures which establish any items of non-compliance, note any absence of written policies, and disclose the reasons why any Agreed Upon Procedures were not performed.

20. *Reviews with Audit Committee and Management.* The independent public accountant should meet with the institution's audit committee to review the accountant's reports required by this part before they are filed. It also may be appropriate for the accountant to review its findings with the institution's board of directors and management.

21. *Notice of Termination.* The notice required by 363.3(c) should state whether the independent public accountant agrees with the assertions contained in any notice filed by the institution under Section 363.4(d), and whether the institution's notice discloses all relevant reasons.

22. *Reliance on Internal Auditors.* Nothing in this part or this appendix is intended to preclude the ability of the independent public accountant to rely on the work of an institution's internal auditor.

Filing and Notice Requirements (363.4)

23. *Place for Filing.* Except for peer review reports filed pursuant to Guideline 16, all reports and notices required by, and other communications or requests made pursuant to, this part should be filed as follows:

    (a) FDIC: Regional Director (Supervision) of the FDIC Regional Office in which the institution is headquartered;

    (b) Office of the Comptroller of the Currency (OCC): appropriate OCC Supervisory Office;

(c) Federal Reserve: appropriate Federal Reserve Bank;

(d) Office of Thrift Supervision (OTS): appropriate OTS District Office; and

(e) State bank supervisor: the filing office of the appropriate state bank supervisor.

24. *Relief from Filing Deadlines.* Although the reasonable deadlines for filings and other notices established by this part are specified, some institutions may occasionally be confronted with extraordinary circumstances beyond their reasonable control that may justify extensions of a deadline. In that event, upon written application from an insured depository institution, setting forth the reasons for a requested extension, the FDIC or appropriate federal banking agency may, for good cause, extend a deadline in this part for a period not to exceed 30 days.

25. *Public Availability.* Each institution's annual report should be available for public inspection at its main and branch offices no later than 15 days after it is filed with the FDIC. Alternatively, an institution may elect to mail one copy of its annual report to any person who requests it. The annual report should remain available to the public until the annual report for the next year is available. An institution may use its annual report under this part to meet the annual disclosure statement required by 12 CFR 350.3, if the institution satisfies all other requirements of 12 CFR Part 350.

26. *Independent Public Accountant's Reports.* Section 36(h)(2)(A) requires that, within 15 days of receipt by an institution of any management letter or other report, such letter or other report shall be filed with the FDIC, any appropriate federal banking agency, and any appropriate state bank supervisor. Institutions and their accountants are encouraged to coordinate preparation and delivery of audit and attestation reports and filing the annual report, to avoid duplicate filings.

27. *Notices Concerning Accountants.* Institutions should review and satisfy themselves as to compliance with the required qualifications set forth in guidelines 13-15 before engaging an independent public accountant. With respect to any selection, change or termination of an accountant, institutions should be familiar with the notice requirements in guideline 21, and should send a copy of any notice under Section 363.4(d) to the accountant when it is filed with the FDIC. An institution which files reports with its appropriate federal banking agency under, or is a subsidiary of a holding company which files reports with the SEC pursuant to, the Securities Exchange Act of 1934 may use its current report (e.g., SEC Form 8-K) concerning a change in accountant to satisfy the similar notice requirements of this part.

Audit Committees (363.5)

28. *Composition.* The board of directors of each institution should determine if outside directors meet the requirements of section 36 and this part. At least annually, it should determine whether all existing and potential audit committee members are "independent of management of the institution." If the institution has total assets in excess of $3 billion, the board also should determine whether members of the committee satisfy the additional requirements of this part. Because an insured branch of a foreign bank does not have a separate board of directors, the FDIC will not apply the audit committee requirements to such branch. However, any such branch is encouraged to make a reasonable good faith effort to see that similar duties are performed by persons whose experience is generally consistent with the Rule's requirements for an institution the size of the insured branch.

29. *"Independent of Management" Considerations.* In determining whether an outside director is independent of management, the board should consider all relevant information. This would include considering whether the director:

(a) Is or has been an officer or employee of the institution or its affiliates;

(b) Serves or served as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of or to the institution or its affiliates;

(c) Is a relative of an officer or other employee of the institution or its affiliates;

(d) Holds or controls, or has held or controlled,

a direct or indirect financial interest in the institution or its affiliates; and (e) Has outstanding extensions of credit from the institution or its affiliates.

30. *Lack of Independence.* An outside director should not be considered independent of management if such director is, or has been within the preceding year, an officer or employee of the institution or any affiliate, or owns or controls, or has owned or controlled within the preceding year, assets representing 10 percent or more of any outstanding class of voting securities of the institution.

31. *Holding Company Audit Committees.* When an insured depository institution subsidiary fails to meet the requirements for the holding company exception in Section 363.1(b)(2) or maintains its own separate audit committee to satisfy the requirements of this part, members of the independent audit committee of the holding company may serve as the audit committee of the subsidiary institution if they are otherwise independent of management of the subsidiary, and, if applicable, meet any other requirements for a large subsidiary institution covered by this part. However, this does not permit officers or employees of a holding company to serve on the audit committee of its subsidiary institutions. When the subsidiary institution satisfies the requirements for the holding company exception in Section 363.1(b)(2), members of the audit committee of the holding company should meet all the membership requirements applicable to the largest subsidiary depository institution and may perform all the duties of the audit committee of a subsidiary institution, even though such holding company directors are not directors of the institution.

32. *Duties.* The audit committee should perform all duties determined by the institution's board of directors. The duties should be appropriate to the size of the institution and the complexity of its operations, and include reviewing with management and the independent public accountant the basis for the reports issued under Sections 363.2(a) and(b) and 363.3(a) and (b). Appropriate additional duties could include:

    (a) Reviewing with management and the independent public accountant the scope of services required by the audit, significant accounting policies, and audit conclusions regarding significant accounting estimates;

    (b) Reviewing with management and the accountant their assessments of the adequacy of internal controls, and the resolution of identified material weaknesses and reportable conditions in internal controls, including the prevention or detection of management override or compromise of the internal control system;

    (c) Reviewing with management and the accountant the institution's compliance with laws and regulations;

    (d) Discussing with management the selection and termination of the accountant and any significant disagreements between the accountant and management; and

    (e) Overseeing the internal audit function. It is recommended that audit committees maintain minutes and other relevant records of their meetings and decisions.

33. *Banking or Related Financial Management Expertise.* At least two members of the audit committee of a large institution shall have "banking or related financial management expertise" as required by section 36(g)(1)(C)(i). This determination is to be made by the board of directors of the insured depository institution. A person will be considered to have such required expertise if the person has significant executive, professional, educational, or regulatory experience in financial, auditing, accounting, or banking matters as determined by the board of directors. Significant experience as an officer or member of the board of directors or audit committee of a financial services company would satisfy these criteria.

34. *Large Customers.* Any individual or entity (including a controlling person of any such entity) which, in the determination of the board of directors, has such significant direct or indirect credit or other relationships with the institution, the termination of which likely would materially and adversely affect the institution's financial condition or results of operations, should be considered a "large customer" for purposes of Section 363.5(b).

35. *Access to Counsel*. The audit committee should be able to retain counsel at its discretion without prior permission of the institution's board of directors or its management. Section 36 does not preclude advice from the institution's internal counsel or regular outside counsel. It also does not require retaining or consulting counsel, but if the committee elects to do either, it also may elect to consider issues affecting the counsel's independence. Such issues would include whether to retain or consult only counsel not concurrently representing the institution or any affiliate, and whether to place limitations on any counsel representing the institution concerning matters in which such counsel previously participated personally and substantially as outside counsel to the committee.

36. *Forming and Restructuring Audit Committees*. Audit committees should be formed within four months of the effective date of this part. Some institutions may have to restructure existing audit committees to comply with this part. No regulatory action will be taken if institutions restructure their audit committees by the earlier of their next annual meeting of stockholders, or one year from the effective date of this part.

Other

37. *Modifications of Guidelines*. The FDIC Board of Directors has delegated to the Director of the FDIC's Division of Supervision authority to make and publish in The Federal Register minor technical amendments to the Guidelines in this appendix (including the attached Agreed Upon Procedures in Schedule A to this appendix), in consultation with the other appropriate federal banking agencies, to reflect the practical experience gained from implementation of this part. It is not anticipated any such modification would be effective until affected institutions have been given reasonable advance notice of the modification. Any material modification or amendment will be subject to review and approval of the FDIC Board of Directors.

Schedule A to Appendix A – Agreed upon Procedures for Determining Compliance with Designated Laws

1. The Agreed Upon Procedures set forth in this schedule are referred to in guideline 19. They should be followed by the institution's independent public accountant (or, with respect to the procedures set forth in section I of this schedule, by the institution's internal auditor if the accountant is to perform the procedures set forth in section II) in order to permit the accountant to report on the extent of compliance with the Designated Laws (defined in guideline 12) as required by sections 36(e)(1) and (2). Unless otherwise stated, the date of any required representation should be the same as the date of the attestation report and the representation should provide information to the extent available as of that date.

2. For purposes of this Schedule A, "insiders" means directors, executive officers, and principal shareholders, and includes their related interests. All terms not defined in this schedule have the meanings given them in this part, the Guidelines, and professional accounting and auditing literature.

3. Additional guidance concerning the role of the institution, its internal auditor, and its independent public accountant in assessing the institution's compliance with the Designated Laws is set forth in the Guidelines.

Section I – Procedures for Individual Institutions

The following procedures should be performed by the institution's independent public accountant in accordance with generally accepted standards for attestation engagements, or by the institution's internal auditor if the procedures set forth in section II of this schedule are to be performed by the independent public accountant. (See section II.B.3. for information concerning testing by the independent public accountant when the institution's internal auditor is performing the procedures in Section I.)

A. *Loans to Insiders*. To the extent permitted by §363.1(b)(2), these procedures may be performed on a holding company basis rather than at each covered subsidiary insured depository institution.

1. *Designated Laws*. The following federal laws and regulations (Designated Insider Laws), to the extent that they are applicable to the institution, should be read:

a. Laws: 12 USC 375a, 375b, 1468(b), 1828(j)(2), and 1828(j)(3)(B); and

b. Regulations: 12 CFR 23.5, 31, 215, 337.3, 349.3, and 563.43.

2. General.

a. Information. Obtain from management of the institution the following information for the institution's fiscal year:[5]

(1) Management's assessment of compliance with the Designated Insider Laws;

(2) All minutes (including minutes drafted, but not approved) of the meetings of the board and of those committees of the board which management represents have been delegated authority pertaining to insider lending;

(3) The relevant portions of reports of examination, supervisory agreements, and enforcement actions issued by the institution's primary federal and state regulators, if applicable, which management represents contain information pertaining to insider lending;

(4) The annual survey which identifies all insiders of the institution (pursuant to 12 CFR 215.8(b)) or other records maintained on insiders of the institution's affiliates (pursuant to 12 CFR 215.8(c));

(5) The relevant portions of the following Securities Exchange Act of 1934 filings, which management represents contain information pertaining to insider lending:

(a) Forms 10-K, 10-Q, and 8-K and proxy statements (or information statements) filed with the SEC, Federal Reserve Board, OCC, or OTS, or

(b) Forms F-2, F-3, and F-4 and proxy statements (or information statements), filed with the FDIC;

(6) A list of loans, including overdrafts of executive officers and directors,[6] and other extensions of credit to insiders (including their related interests) outstanding at any time during the fiscal year (and which identifies those extensions granted during the year). This list should also include the amount outstanding of each extension of credit as of the date of the most recently filed Call Report or TFR (Insider Extensions List); and

(7) Management's representation concerning:

(a) The completeness of the Insider Extensions List;[7] and

(b) The inclusion of all required insiders on the annual survey obtained in paragraph A.2.a.(4) of this section including persons who have been designated as executive officers by resolution of the board or a committee of the board or in the by-laws of the institution.

b. Procedures:

(1) Read the foregoing information.

(2) Trace and agree a sample of insider loans and other extensions of credit disclosed in the documents listed in paragraphs A.2.a.(2) through (5) of this section to see that they are included on the Insider Extensions List.

3. Policies and Procedures.

a. Information. Obtain the institution's written policies and procedures concerning its compliance with the Designated Insider Laws,

[5] If the institution chooses to have these procedures performed using its most recently filed Call Report rather than its year end Call Report, all references to "fiscal year" in these procedures shall mean the period beginning with the latest Call Report date for which these procedures were performed in the prior year and ending with the date of the most recently filed Call Report. If these procedures were not previously performed, the 12 month period immediately preceding the date of the most recently filed Call Report (or such shorter period during which the institution was covered by this Part 363) should be used.

[6] Management may exclude from this list overdrafts of an executive officer or director in an aggregate amount of $1,000 or less without overdraft protection and those of $5,000 or less with overdraft protection as specified in 12 CFR 215.3(b)(6) if management provides the independent accountant with a representation that policies and procedures are in effect to report as extensions of credit all overdrafts that do not meet the criteria listed in paragraphs A.8.a.(2)(a) through (c) of this section.

[7] See footnote 6 of this schedule.

including any written "Code of Ethics" or "Conflict of Interest" policy statements. If the institution has no written policies and procedures, obtain a narrative from management that describes the methods for complying with such laws and regulations, and includes provisions similar to those listed in paragraph A.3.b. of this section.

b. Procedures. Ascertain that the policies and procedures include, or incorporate by reference, provisions consistent with the Designated Insider Laws for:

(1) Defining terms;

(2) Restricting loans to insiders;

(3) Maintaining records of insider loans;

(4) Requiring reports and/or disclosures by the institution and by executive officers, directors, and principal shareholders (and their related interests);

(5) Disseminating policy information to employees and insiders; and

(6) Prior approval of the board of directors.

4. Calculations of Lending Limits.

a. Information. Obtain management's calculation of the following items as of the date of the institution's most recently filed Call Report or TFR and as of a Call Report or TFR date six or nine months earlier:

(1) The institution's unimpaired capital and surplus (the aggregate lending limit for all insiders); and

(2) The institution's individual lending limit (12 CFR 215.2(i)).

b. Procedures. Recalculate the amounts in paragraph A.4.a. of this section for mathematical accuracy, and trace the amounts used in management's calculations to the Call Reports or TFRs for the two dates used in paragraph A.4.a. of this section.

5. Insider Extensions of Credit Granted.

a. Information. Obtain management's representation regarding whether the terms and creditworthiness of insider extensions of credit granted during the fiscal year are comparable to those that would have been available to unaffiliated third parties.

b. Procedures. Select a sample of insiders who were granted or had outstanding extensions of credit during the fiscal year from the Insider Extensions List. For each extension of credit granted during the fiscal year to each insider in the sample selected:

(1) If the amount of a credit granted during the year (when aggregated with all other extensions of credit to that person and to all related interests of that person) exceeds $ 500,000, determine whether the minutes of the meetings of the board of directors indicate that:

(a) The credit was approved in advance by the board, and

(b) The insider, if a director, abstained from participating directly or indirectly in voting on the transaction;

(2) Obtain management's calculation of the institution's individual lending limit for insiders pursuant to 12 CFR 215.2(i) as of the date of the Call Report or TFR filed immediately prior to the date when the extension of credit was granted, and if not already done under paragraph A.4.b. of this section, recalculate the lending limits for mathematical accuracy, and trace the amounts used in management's calculations to the Call Report or TFR for that date. Ascertain whether the amount of the extension of credit being granted to the insider, when combined with all other extensions of credit to that insider, exceeds such limit; and

(3) For one transaction involving each insider in the sample selected in paragraph A.5.b. of this section, perform the procedures in either paragraph (a) or (b) as follows:

(a) Select three (or such smaller number that exists) similar extensions of credit (e.g., commercial real estate loans,

floor plan loans, residential mortgage loans, consumer loans) granted to unaffiliated borrowers (i.e., persons who are not insiders or employees of the institution or its affiliates) within 90 days before or after the granting of the insider extension of credit. Compare the terms of the transactions with unaffiliated borrowers (i.e., rate or range of interest rates, maturity, payment terms, collateral, and any unusual provisions or conditions) to those with the insiders, and note in the findings any differences in the terms favorable to the insiders compared to the terms of the transactions with unaffiliated borrowers.

(b) Alternatively, compare the terms of each insider transaction in the sample to approved policies delineating the interest rate and other terms and conditions then in effect for similar extensions of credit to unaffiliated borrowers. Note in the findings any differences in the terms favorable to the insiders compared to the terms of the approved policies for an extension of credit to persons not affiliated with the institution or its affiliates.

6. Limitation on Extensions of Credit to Executive Officers.

a. Information. From the sample selected in paragraph A.5.b. of this section, select the executive officers who were granted extensions of credit during the fiscal year.

b. Procedures.

(1) For each executive officer selected, obtain management's calculation as of the two dates used in paragraph A.4.a. of this section of:

(a) The aggregate amount of extensions of credit to the executive officer, and

(b) 2.5 percent of the institution's unimpaired capital and surplus.

(2) Recalculate management's computations from paragraph A.6.b.(1) of this section for mathematical accuracy. Trace amounts used in management's computations from paragraph A.6.b.(1) to the Call Reports or TFRs for the two dates used in paragraph A.4.a. of this section.

(3) Ascertain whether the aggregate amount of the extensions of credit to the executive officer does not exceed the greater of $ 25,000 or 2.5 percent of the institution's unimpaired capital and surplus, but in no event more than $ 100,000. The aggregate amount should exclude the types of extensions of credit set forth in 12 CFR 215.5(c)(1) through (3).

(4) (a) Obtain documentation for any credits for which management represents that:

(i) The purpose is for the purchase, construction, maintenance, or improvement of the executive officer's residence;

(ii) The credit is secured by a first lien on the residence; and

(iii) The executive officer owns or expects to own the residence after the extension of credit.

(b) Note whether the documentation contains similar representations.

(5) For each executive officer selected, ascertain that each extension of credit granted during the fiscal year was:

(a) Preceded by submission of financial statements;

(b) Approved by, or, when appropriate, promptly reported to, the board of directors no later than the next board meeting; and

(c) Made subject to the written condition that the extension of credit will become, at the option of the institution, due and payable at any time that the executive officer is indebted to other insured institutions in an aggregate amount greater than the executive officer would be able to borrow from

the institution.

7. Aggregate Insider Extensions of Credit Outstanding.

   a. Information. Obtain management's calculation of the aggregate extensions of credit to executive officers, directors, and principal shareholders of the institution and to their related interests, excluding the types of extensions of credit set forth in 12 CFR 215.4(d)(3), as of the two dates selected in paragraph A.4.a. of this section.

   b. Procedures.

      (1) Recalculate the amounts obtained in paragraph A.7.a. of this section for mathematical accuracy and ascertain that this total, excluding the types of extensions of credit set forth in 12 CFR 215.4(d)(3), is less than or equal to 100 percent of the institution's unimpaired capital and surplus calculated in paragraph A.4.a.(1) of this section.

      (2) Using the sample of insiders selected in paragraph A.5.b. of this section, trace and agree amounts outstanding from insiders in the sample to the supporting documents, as applicable, for the line item aggregating indebtedness of all insiders on the institution's most recently filed Call Report or TFR.

8. Overdrafts.

   a. Information. Select a sample of executive officers and directors who had overdrafts outstanding during the fiscal year as shown on the Insider Extensions List.

      (1) For all overdrafts in the sample except those which are covered by an overdraft protection line of credit with the same terms as available to unaffiliated borrowers and meet the terms of that overdraft protection line, obtain management's representation of the history of the insider's overdrafts for the year and the completeness of that history.

      (2) If the institution's management has not provided a representation as specified by footnote 3 to paragraph A.2.a.(6) of this section, for each overdraft in the sample in an aggregate amount of $ 1,000 or less for an executive officer or director who did not have the overdraft covered by an overdraft protection line of credit, obtain management's representation that:

         (a) It believes the overdraft was inadvertent;

         (b) The account was overdrawn in each case for no more than 5 business days; and

         (c) The institution charged the executive officer or director the same fee that it would charge any other customer in similar circumstances.

   b. Procedures. For each overdraft in the sample selected and used in paragraph A.8.a.(1) of this section for which management did not provide the representation in paragraph A.8.a.(2) of this section:

      (1) Inquire whether cash items for the insider were being held by the institution during the time that the overdraft was outstanding to prevent additional overdrafts;

      (2) Trace and agree subsequent payment by the insider of the insider's overdrafts to records of the account at the institution; and

      (3) For overdrafts of executive officers and directors that were paid by the institution for the executive officer or director from an account at the institution:

         (a) Trace and agree to a written, pre-authorized, interest-bearing extension of credit plan that specifies a method of repayment; or

         (b) Trace and agree to a written, pre-authorized transfer of funds from another account of the insider at the institution.

9. Reports on Indebtedness to Correspondent Banks.

   a. Information. Obtain from management:

      (1) A list of executive officers and principal shareholders and related interests thereof

that filed reports of indebtedness to a correspondent bank. This list should be prepared by management from reports of indebtedness submitted for the calendar year for which the management assessment and independent public accountant's attestation are being filed or, if the institution is on a calendar year fiscal year, at management's option, for the immediately preceding year. If the institution is not on a calendar year fiscal year, the list should be prepared for the calendar year that ended during its fiscal year; and

(2) Its representation concerning the completeness of the list prepared for paragraph A.9.a.(1) of this section.

b. Procedures. Select a sample of executive officers, principal shareholders, and related interests thereof from the list obtained in paragraph A.9.a.(1) of this section. For each executive officer and principal shareholder (or related interest thereof) included in the sample, ascertain that the report(s) of indebtedness was (were) filed with the board of directors (on or before the January 31 following the calendar year in paragraph A.9.a.(1) of this section) and that such report(s) state(s):

(1) The maximum amount of indebtedness during that calendar year;

(2) The amount of indebtedness outstanding 10 days prior to report filing; and

(3) A description of the loan terms and conditions, including the rate or range of interest rates, original amount and date, maturity date, payment terms, collateral, and any unusual terms or conditions.

B. Dividend Restrictions. If the institution has declared any dividends during the fiscal year, the following procedures should be performed for each dividend declared. (These procedures are not applicable to mutual institutions and insured branches of foreign banks.) For an institution that is a subsidiary of a holding company, the procedures that follow should be applied to each subsidiary institution subject to this part (covered subsidiary) because the laws and regulations restricting dividends apply to individual institutions and not holding companies. However, if the annual report under Part 363 is being prepared on a holding company basis and the holding company has more than five covered subsidiaries, the following procedures may be applied to a sample of dividend declarations to the extent permitted by §363.1(b) and Section II.B.3. of this schedule.

1. Designated Laws. The following federal laws and regulations (Designated Dividend Laws), to the extent that they are applicable to the institution (see paragraph B.2 of this section),[8] should be read:

a. Laws: 12 USC 56, 60, 1467a(f), 1831o; and

b. Regulations: 12 CFR 5.61, 5.62, 6.6, 7.6120, 208.19, 208.35, 325.105, 563.134, and 565.

2. General. The information requirements and procedures in paragraphs B.2. through B.5. of this section are applicable to all institutions. Paragraphs B.6. and B.7. of this section were designed to be applicable to member banks (i.e., national banks and state member banks) and federally-chartered savings associations, respectively. However, the requirements in paragraphs B.6. and B.7. of this section should be applied to a state nonmember bank or state savings association if management represents that the state has dividend restrictions substantially identical to those for a national bank or a federally-chartered savings association.

a. Information. Obtain from management of the institution the following information for the institution's most recent fiscal year:

(1) Its assessment of the institution's compliance with the Designated Dividend Laws and any applicable state laws and regulations cited in its assessment;

(2) A copy of any supervisory agreements with, orders by, or resolutions of any regulatory agency (including a description of the nature of any such agreements, orders, or resolutions) containing restrictions on dividend payments by the institution; and

(3) Its representation whether dividends

[8] The laws and regulations applicable to each type of institution are listed in Table 1 of this Schedule A to Appendix A.

declared comply with any restrictions on dividend payments under any supervisory agreements with, orders by, or resolutions of any regulatory agency (including a description of the nature of any such agreements, orders, or resolutions).

b. Procedures.

(1) Read the foregoing information.

(2) If any restrictions on dividend payments exist in any documents obtained in paragraph B.2.a.(2) of this section, test and agree dividends declared with any such quantitative restrictions.

3. Policies and Procedures.

a. Information. Obtain the institution's written policies and procedures concerning its compliance with the Designated Dividend Laws. If the institution has no written policies and procedures, obtain from the institution a narrative that describes the institution's methods for complying with the Designated Dividend Laws, and includes provisions similar to those in paragraph B.3.b of this section.

b. Procedures. Ascertain whether the policies and procedures include, or incorporate by reference, provisions which are consistent with the Designated Dividend Laws. These would include capital limitation tests, including section 38 of the Federal Deposit Insurance Act (12 USC 1831o), earnings limitation tests, transfers from surplus to undivided profits, and restrictions imposed under any supervisory agreements, resolutions, or orders of any federal or state depository institution regulatory agency. In addition, for savings associations, this would include prior notification to the OTS.

4. Board Minutes.

a. Information. Obtain the minutes of the meetings of the board of directors for the most recent fiscal year to ascertain whether dividends (either paid or unpaid) have been declared.

b. Procedures. Trace and agree total dividend amounts to the general ledger records and the institution's most recently filed Call Report or TFR.

5. Calculation of Undercapitalization.

a. Information. Obtain management's computation of the amount at which declaration of a dividend would cause the institution to be undercapitalized as of the quarter end (or more recent month end, if available from management) immediately prior to the date on which each dividend was declared during the fiscal year.

b. Procedures. Recalculate management's computation (for mathematical accuracy) and compare management's calculations to the amount of any dividend declared to determine whether it exceeded the amount.

6. Dividends Declared by Banks.

a. Information. If the institution is a national bank or state member bank, obtain management's computations concerning the bank's compliance with 12 USC 56, "Capital Limitation Test", 12 USC 60, "The Earnings Limitation Test", and transfers from surplus to undivided profits after declaration of the dividends referenced in paragraph B.4.a. of this section. If the institution is a state nonmember bank and management represents that the bank is subject to state laws that are similar to 12 USC 56 and 12 USC 60, obtain management's corresponding computations.

b. Procedures. Recalculate management's computations (for mathematical accuracy) and compare management's calculations to the standards defined in the tests set forth in paragraph B.6.a. of this section to ascertain whether the dividends declared fall within the permissible levels under these standards. If dividends are not permissible in the amounts declared under such standards, the independent public accountant should ascertain that the dividends were declared with the approval of the appropriate federal banking agency or under any other exception to the standards.

7. Dividends Declared by Savings Associations.

a. Information. Obtain management's documentation of the OTS determination

whether the institution is a Tier 1, Tier 2, or Tier 3 savings association and management's computations of its capital ratio after declarations of dividends under the Tier determined by the OTS. For dividends declared, obtain copies of the savings association's notifications to the OTS to ascertain whether notifications were made at least 30 days before payment of any dividends.

b. Procedures. Recalculate management's computations (for mathematical accuracy) and trace amounts used by management in its calculations to the institution's TFRs.

Section II – Procedures for Independent Public Accountant

If the internal auditor has performed the procedures set forth in section I for either or both Designated Laws, the following procedures may be performed by the independent public accountant if neither the FDIC nor the appropriate federal banking agency has objected in writing. The report of procedures performed and list of exceptions found by the internal auditor, identifying the institution with respect to which any exception was found, should be submitted to the audit committee of the board of directors. Management should file a summary of the internal auditor's findings and management's response to those findings with the FDIC and the appropriate federal banking agency at the same time as the independent public accountant's attestation report is filed.[9]

A. Review of Section I Procedures. Read the portion(s) of Section I of this schedule that set forth the procedures performed by the internal auditors.

B. Information and Procedures. Perform the following procedures:

1. Designated Laws. Read the Designated Laws referred to in Section I of this schedule for the agreed-upon procedures performed by the internal auditor. Obtain management's assessment contained in its management report on the institution's or holding company's compliance with the Designated Laws.

2. Internal Auditor's Workpapers.

a. Information. If an internal auditor performed the procedures in Section I, obtain the internal auditor's workpapers documenting the performance of those procedures on the institution and the chief internal auditor's representation that:

(1) The internal auditor or audit staff, if applicable, performed the procedures listed in section I on the institution;

(2) The internal auditor tested a sufficient number of transactions governed by the Designated Laws so that the testing was representative of the institution's volume of transactions;

(3) The workpapers accurately reflect the work performed by the internal auditor and, if applicable, the internal audit staff;

(4) The workpapers obtained are complete; and

(5) The internal auditor's report, which describes the procedures performed for the fiscal year as well as the internal auditor's findings and exceptions noted, has been presented to the institution's audit committee.

b. Procedures.

(1) Compare the workpapers to the procedures that are required to be performed under section I. Report as an exception any procedures not documented and any procedures for which the sample size is not sufficient.

(2) Compare the exceptions and errors listed by the internal auditor in its report to the audit committee to those found in the workpapers, and report as an exception any exception or error found in the internal auditor's workpapers and not listed in the internal auditor's list of exceptions.

3. Testing.

a. The independent public accountant should

[9] Since this summary provides information similar to that provided in the independent public accountant's report, the FDIC has determined that the summary is exempt from public disclosure consistent with the guidance in Guideline 18 in Appendix A to this Part 363.

perform the procedures listed in Section I on representative samples of the insiders and/or transactions of the institution to which the Designated Law applies. If the institution's internal auditor performs the procedures in Section I, the samples tested by the independent public accountant should be at least 25 percent of the size of the samples tested by the internal auditor although samples selected by the accountant should be from the population at large. However, if there are so few transactions in any area that the internal auditor cannot use sampling, but must test all transactions, the independent public accountant should also test all transactions.

b. If testing under this Schedule A to Appendix A is being performed on a holding company with more than one subsidiary institution that is subject to this Part 363, the samples tested should include a combination of insiders and transactions from each covered subsidiary with total assets (after deductions of intercompany amounts that would be eliminated in consolidation) in excess of 25 percent of the holding company's total assets every fiscal year. Samples should be tested for each smaller covered subsidiary at least every other fiscal year unless the holding company has more than eight covered subsidiaries, in which case the samples to be tested for each Designated Law should be drawn from each smaller covered subsidiary at least every third fiscal year.

4. Reports Concerning Holding Companies. Only one report of any exceptions noted from application of the procedures in section II performed by the independent public accountant should be filed as required by guideline 3 in Appendix A to this Part 363, but the report should identify, for each exception or error noted, the identity of the covered subsidiary to which it relates.

Tables to Schedule A to Appendix A
Table 1

	Loans to insiders	For engagements involving management assertions about compliance by: National Banks	State member banks	State nonmember banks	Savings associations
Read the following parts and/or sections of Title 12 of the United States Code:					
375a	Loans to Executive Officers of	✓	✓	✓*Subsections (g) And (h) only*	
375b	Prohibitions Respecting Loans and Extensions of Credit to Executive Officers and Directors of Banks, Political Campaign, Committees, etc	✓	✓		
1468(b)	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders				✓
1828(j)(2)	Provisions Relating to Loans, Extensions of Credit, and Other Dealings Between Member Banks and Their Affiliates, Executive Officers, Directors, etc				✓
1828(j)(3)(B)	Extensions of Credit Applicability of Provisions Relating to Loans, Extensions of Credit and Other Dealings Between Insured Branches of Foreign Banks and Their Insiders	✓ *Applies only to insured federal branches of foreign banks*		✓ *Applies only to insured state branches of foreign banks*	
Read the following parts and/or sections of Title 12 of the Code of Federal Regulations:					
23.5	Application of Legal Lending Limits; Restrictions on Transactions With Affiliates		✓		
31	Extensions of Credit to National Bank Insiders	✓			
215	Subpart A – Loans by Member Banks to their Executive Officers, Directors, and Principal Shareholders	✓	✓	*(See 12 CFR parts 337.3 and 349.3)*	*(See 12 CFR Parts 563.43)*
	Subpart B – Reports of Indebtedness of Executive Officers and Principal Shareholders of Insured Nonmember Banks		✓	✓	
337.3	Limits on Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Insured Nonmember Banks			✓	
349.3	Reports by Executive Officers and Principal Shareholders				✓
563.43	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders				✓

Table 2

	Dividend restrictions	For engagements involving management assertions about compliance by: National banks	State member banks	State nonmember banks	Savings associations
Read the following parts and/or sections of Title 12 of the United States Code:					
56	Prohibition of Withdrawal of Capital an Unearned Dividends	✓	✓		
60	Dividends and Surplus Funds	✓	✓		
1467a(f)	Declaration of Dividends				✓
1831o	Prompt Corrective Action-- Dividend Restrictions	✓	✓	✓	✓
Read the following parts and/or sections of Title 12 of the Code of Federal Regulations:					
5.61	Payment of dividends; capital limitation	✓			
5.62	Payment of dividends; earnings limitation	✓			
6.6	Prompt Corrective Action- Dividend Restrictions	✓			
7.6120	Dividends Payable in Property Other Than Cash	✓			
208.19	Payments of Dividends		✓		
208.35	Prompt Corrective Action			✓	
325.105	Prompt Corrective Action			✓	
563.134	Capital Distributions				✓
565	Prompt Corrective Action				✓

TABLE 24.1 LAW AND REGULATION REFERENCES		
Law/Regulation Cite	**Reference**	**Responsible Agency**
12 USC 363 [1]	FDIC Improvement Act	FDIC
12 USC 371c; Section 23-A	Transactions with Affiliates Federal Reserve Act, Section 23-A	FRB, OCC
12 USC 371c-1; Section 23-B	Restrictions on Transactions with Affiliates Federal Reserve Act, Section 23-B	FRB, OCC
12 USC 375	Purchases from Directors and Sales to Directors	
12 USC 1811 et seq [1]	Financial Institution Examination Reform, Recovery, and Enforcement Act of 1989	
12 USC 1820(d)	Examination Frequency	
12 USC 1861 - 1867 [1]	Bank Service Corporation Act	
12 USC 1972	Tying Arrangement for Correspondent Accounts	
15 USC 78(m)(b)	Foreign Corrupt Practices Act	
15 USC 271, 272, 278g-3 40 USC 758,759	Computer Security Act of 1987	
18 USC 1030	Computer Fraud and Abuse Act of 1986	
18 USC 1367, 2232, 2510 et seq, 2701 et seq, 3117, 3121	Electronic Communications Privacy Act of 1986	
18 USC 2510 et seq	Wire Interception and Interception of Oral Communications Act of 1968	
31 USC 5314	Foreign Financial Agency Recordkeeping (Reports of Currency and Foreign Transactions)	
12 CFR 7.1019	Electronic Products and Services	OCC
12 CFR 210	Collection of Checks and other Items by Federal Reserve Banks and Funds Transfer Through Fedwire Federal Reserve - Regulation J	FRB
12 CFR 225.22 [1]	Bank Holding Company Act	FRB
31 CFR 103.33	Bank Secrecy Act - Financial Recordkeeping (Reports of Currency and Foreign Transactions)	FINCEN [2]

[1] These law cites are detailed more fully in Laws and Regulations (Chapter 24) of the Handbook.
[2] Financial Crimes Enforcement Network