

FRB IS EXAMINATION POLICY ISSUANCES CHAPTER 27 (SUPERVISION AND REGULATION DIVISION)

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 81- 678
March 27, 1981

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

On March 18, 1981 the Board approved the alternate year examination program (AEP) as System policy for the commercial examination of State member banks. The AEPs would also include trust and electronic data processing examinations if the State has sufficient examination expertise, but would not include consumer affairs and CRA examinations. Under the program, certain mutually agreed upon State member banks that are relatively free of problems would be divided into two groups, with each group being examined in alternate years by the Reserve Bank and the State. Thus, a particular bank would be examined by the Reserve Bank in one year, the State in the next and so on. The program will not restrict the supervisory prerogatives or alter the supervisory responsibilities of either the Federal Reserve or the States. While the program is meant to encourage Federal Reserve-State cooperation, any bank may be removed from the program and examined at any time by either agency, and either agency can meet with a bank's management or board of directors or initiate supervisory action whenever deemed warranted.

Adoption of AEP amends the Federal Reserve's examination frequency policy by permitting the time between System examinations of relatively trouble-free banks to be extended from 18 months to 24 months, provided a State examination under AEP is conducted in the interim. In some instances, judgment may be exercised if commencing a Federal Reserve examination and the bank's condition does not warrant an immediate on-site Federal Reserve examination. Banks requiring more than normal supervisory attention, banks not included under the alternate schedule for reasons of size and certain other banks at the discretion of either agency will continue to be examined under existing frequency policies.

The program will be implemented on a state-by-state basis with those States that have an interest and adequate examination staffs. In determining the adequacy of state examination programs, Reserve Banks should consider the level of expertise and experience of state examiners, the size of the examination force, and the quality and scope of state examinations. Generally, commercial examinations should include an analysis of all determinants of safety and soundness, an evaluation of internal systems and management, a review of the accuracy of supervisory reports and an assessment of compliance with general banking laws, regulations and supervisory policies. Reserve Banks should cooperate with the States in order to enhance the State examiners' understanding of Federal laws and regulations, especially those designed to limit risk-taking and extensions of credit to affiliates and insiders. If a state is split between more than one Reserve District, the two Reserve Banks should be consistent in determining whether it would be appropriate to conduct the AEP with that state and should negotiate an AEP arrangement with the State on that basis. If two Reserve Banks cannot reach a consensus on the State, the Reserve Banks should send to Board staff a written account of why such a disagreement exists. The situation will then be presented to the Board's

Committee on Banking.

Supervision and Regulation for resolution. States that have a statutory annual examination requirement might be able to participate in AEP and still satisfy the requirement by sending a representative along with the Reserve Bank's examination team.

The program will be initiated through a memorandum of understanding or letter agreement between the Reserve Bank and the State. (A proposed minimum agreement format is attached.) Aside from provisions listed in the attachment, the format of AEP agreements will be flexible to accommodate particular Reserve Bank and/or State needs and changing conditions within the banking industry. Some examples of such provisions might include: a) a size criterion for including banks in AEP if either agency's resource limitations would preclude its conducting independent examinations of larger institutions; b) on-site representation of one agency during an alternate examination being conducted by the other agency; and c) agreement to assist the State examiners in understanding Federal banking laws and regulations. Reserve Banks should notify the Projects and Planning Section when discussions regarding AEP are started with any State banking department and should send Board staff a copy of the draft agreement negotiated with the State banking department prior to final implementation.

The Reserve Bank and the State banking department should meet in advance to mutually agree on the list of banks whose examinations are to be alternated in the subsequent examination period. Further meetings should be held periodically to add or delete banks from the list if warranted by changing financial conditions. The list of mutually agreed upon State member banks should be accorded confidential treatment by the Reserve Bank and the State banking department. In deciding whether to include large banks with significant shared national credits (SNCs) or loans involving country risk, Reserve Banks should carefully consider the supervisory treatment the State accords these areas. States should be encouraged to participate in these programs or to incorporate classification schemes consistent with the SNC and country risk programs. Reserve Banks should stand ready to assist States in these areas if necessary. State member banks included under the AEP normally would be rated CAMEL composite 1 or 2. Nonetheless, a particular bank rated composite 1 or 2 might be excluded from AEP if the Reserve Bank or State banking department felt it would be necessary to examine that bank under the existing examination policy for a specific reason relating to the nature of the bank's business, a particular finding regarding the bank's operation, or the bank's size. In addition, improving composite 3's could be included, while deteriorating composite 1's or 2's could be excluded.

The initial phase of the program would run for two years to allow one full cycle of alternated examinations to be conducted. Within this two-year period, all banks included in AEP should be examined at least once by the Reserve Bank. Thereafter, the program could be reviewed and extended in a manner mutually agreeable to the Reserve Bank and the State. This is not to imply that the agencies would meet or communicate only to determine whether to continue the program; rather the program should be established on a fundamental understanding that timely communication and exchange of information and close cooperation are essential to the success and continuance of the AEP. While the program may be terminated anytime at the discretion of either agency, Reserve Bank concerns about how the program is progressing or working should be discussed with Board staff before approaching the State for the purpose of limiting or possibly terminating the program.

Due to the extension of time between Federal Reserve examinations of AEP banks, Reserve Banks should closely monitor the financial condition of such banks through the financial surveillance and screening programs. Such activities and off-premise analyses should be stepped up and strengthened where necessary. CAMEL ratings should be updated between Federal Reserve examinations whenever there is a material change in financial condition based upon State examinations, call and

income and dividend reports and other relevant information. SR-665 outlines procedures to be followed to effect a change in rating between System examinations.

Reserve Banks should receive and analyze all examination reports from the States which are prepared on banks included in AEP. A written analysis of each State examination report should be forwarded to Board staff along with a copy of the examination report.

Implementation of the program will foster greater cooperation and joint supervisory actions, but is not meant to limit the Reserve Bank's supervisory responsibilities, prerogatives or flexibility. The program should result in a reduction of duplication and the elimination of separate Federal and State examinations of certain sound banks in one year and thereby produce some budget savings. However, in many instances it will be necessary to use these savings in order to strengthen the on-site coverage of bank holding companies and the off-premise surveillance and analysis activities that are required to implement the AEP and the recently enacted examination frequency policy.

Questions concerning the program as well as notification of the initiation or conduct of discussions with States should be directed to Richard Spillenkothen (x2594) or Rita Corwin (x2740). It is recognized that implementation of AEPs may have to be accomplished over time by gradually increasing the number of banks whose examinations are alternated as both the Reserve Bank and the State gain experience in participating in the program.

/s/John E. Ryan
Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 81-703
July 13, 1987

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

We present the following guidelines in response to various questions that have been raised by Reserve Districts regarding the EDP Examination Program,

Interagency Policy Statement (SR-475)-Examination responsibility for Remote Job Entry (RJE) sites. Recently, many financial institutions have entered into RJE computer servicing arrangements. Unlike conventional types of computer servicing arrangements, RJE's allow data processing operations (input/output) to be conducted at financial institutions remotely located from the main computer center. In these cases, the regulatory agency that supervises the financial institution in which the RJE is located should conduct the EDP examination of the RJE site. Alternate examination arrangements can be made between the Federal regulatory agencies, however, such arrangements should be fully discussed among the agencies at the district/regional level prior to conducting the examination.

Interagency Rating System (SR-507)-Performance rating for each function. The rating system is based on an evaluation of the four critical functions of a data Processing operation: audit, management, systems and programming and computer operations. Regardless of whether the organization being examined performs each function, a numerical rating must be assigned to each function during the examination.

Specifically, audit and systems and programming ratings are frequently omitted in the Administration section of the EDP Report of examination. As examples:

- (1) An organization may not have an internal auditor, however, an audit function should exist. To formulate an EDP audit performance rating, determine if appropriate audit standards and procedures have been developed and are being followed.
- (2) Regardless of the amount of in-house programming an organization conducts, controls should be maintained over computer software and program modifications. To evaluate the performance of the systems and programming function, examiners should review areas such as software controls, security and backup of software documentation, system enhancement and program change procedures and vendor support.

**EDP Report of Examination (SR-640)-Report pages
and sections that are often incorrectly prepared**

COVER

- (1) Use the standard interagency cover page for all EDP Reports of Examination. (State member banks, independent data processing companies, subsidiaries or affiliates of bank holding companies, bank service corporations, etc.)
- (2) List the "Agency" name for the Federal Reserve System as THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.
- (3) State the appropriate Federal Reserve Bank name following the examiners name. (Only lead examiners should be named on the cover page.)

ADMINISTRATIVE SECTION

- (1) Page A: LIST each function rating as well as the composite rating for prior examination information.
- (2) Page C: Systems Description-Include the core storage capacity, name of the operating system and programming language in the hardware and software descriptions.
- (3) Page C: Organizational Structure-Report the total number of employees that are employed in the financial Institution or data center. In addition, specify the number of persons that work in the computer operations and systems and programming functions of the organization. (NOTE: The total number of employees should be greater than the sum of both functions.)
- (4) Page C: Ownership-state any affiliation a bank or data center may have with another bank or bank holding company. (Provide the name and location.)

/s/John E. Ryan
Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 82-42(FIS)
August 16, 1982

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

SUBJECT: EDP Examination Guidelines for Facilities Management Operations

The Interagency EDP Examination Subcommittee has developed the following guidelines for uniform report preparation and distribution of data centers operating under a facilities management agreement. The guidelines are being distributed to each District/Region of the participating agencies.

DEFINITIONS

For the purpose of these guidelines:

- An Examined Organization is a financial institution or data center that contracts another organization's employees and/or computer equipment to develop, implement and operate a data processing function on its behalf.
- A Facilities Management (FM) Organization is an organization responsible for operating all or part of a data processing function under the provisions and agreements set forth in a written contract.

REPORT PREPARATION

The names and locations of both the examined organization and the FM organization should be reported on the cover of the EDP examination report as follows:

- Record the name and location of the examined organization in the areas marked (Data Center) (City) (County) and (State).
- Record the name and location of the FM organization (as it appears on the contract) on the line below the date of the examination.
- Include financial statements of the FM organization and the examined organization (unless it is a financial institution) in the EDP examination report. Examiners should analyze the financial condition of both entities and include relative comments on the Administrative Remarks page of the confidential section.
- Describe the organizational structure and processing arrangements (hardware, software,

personnel) in the confidential section.

REPORT DISTRIBUTION

Distribute a copy of the EDP examination report to the board of directors of the examined organization and the FM organization.

- Unless there are unusual circumstances, an unabridged copy of the report should be sent to the examined organization.
- Comments which specifically address the examined organization only should be edited from the report distributed to the FM organization.

/s/John E. Ryan

Director

Cross References: SR-640

Supersedes: N/A

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 84-19(FIS)
July 24, 1984

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

In 1975 the Board issued instructions (S-2285) to the Reserve Banks regarding offsite electronic facilities. The instructions state in part:

"The Board has recently considered a request by a State member bank to establish offsite electronic facilities. Many such facilities have the capacity to accept deposits, make loans, or pay checks, and have become generally known as cash dispensers, automated tellers, and point-of-sale terminals."

"In view of the legal and policy issues raised by the establishment or use of offsite facilities that provide any or all of the above described services, the Board has determined that, at this time, a State member bank desiring to establish or use an offsite electronic facility described above shall inform the Federal Reserve Bank in its district thirty days prior to the establishment or utilization of such facility. Where applicable State law or the appropriate State bank supervisory authority has permitted or approved deployment of the proposed offsite facility, and where the Reserve Bank does not notify the applicant of its objection to the establishment or use of the facility within the 30-day period, the member bank may take action to establish or use such facility."

The Board's Rules of Procedures provide that an application by a State member bank for establishment of a domestic branch or other facility (offsite electronic facility) that would be authorized to receive deposits is subject to CRA publication requirements.

While the above quoted instructions remain outstanding, some confusion has arisen as to the interpretation of the instructions. The Board recently authorized Board Staff to join with the Comptroller of the Currency in filing an amicus brief in a court case involving the branch status of an automatic teller machine (ATM). The Board took the position that if a bank (1) did not own or rent a particular ATM and (2) if that ATM was shared with other institutions, then the ATM would not be considered a branch requiring notification. Offsite electronic facilities not satisfying both of these tests should be regarded as a branch of each bank that uses the facility.

When a state member bank joins a network that meets both of the above tests, it should advise the Reserve Bank of such action by letter even though no branch application is required. Moreover, the

network should advise the Reserve Bank on a quarterly basis of the location of each facility added to the network.

State member banks in your District should be advised of these procedures if they vary from your current practices.

/s/John E. Ryan
Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 86-39 (SA)
November 7, 1986

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Frequency and Scope of Specialized Examinations

As you know, the new Frequency Guidelines for Commercial and Bank Holding Company Examinations (SR 85-28 (FIS)) did not address specialized examinations, such as examinations for trust institutions (bank trust departments and trust companies), registered transfer agents, registered clearing agents, EDP operations and municipal securities dealers. Staff has now completed a detailed review of the frequency requirements for these specialized examinations and individualized frequency guidelines, which take into account the differences in the nature of these specialized areas, have been adopted as set forth below. Tables presenting these frequency and scope requirements are attached.

More frequent examinations should, of course, be scheduled by Reserve Banks if necessary.

Trust Examinations

A trust institution rated U.I.T.R.S.¹ composite 1 or 2 at the last examination with total discretionary assets greater than \$500 million will be subject to a full-scope examination every two years to be conducted either by the Federal Reserve independently or jointly with the State, provided that the Reserve Bank has no reason to believe that there has been a material change and/or deterioration in the institution's management, condition, or character of business since the last examination, and all substantive issues commented upon in the last examination report have been satisfactorily resolved. A trust institution rated U.I.T.R.S. composite 1 or 2 with total discretionary assets between \$100 and \$500 million will be subject to a full-scope examination every three years by the Federal Reserve, provided an acceptable State examination is conducted in the interim (otherwise every two years). A trust institution rated U.I.T.R.S. composite 1 or 2 with total discretionary assets less than \$100 million will be subject to a full-scope examination every four years by the Federal Reserve, provided an acceptable State examination is conducted in the interim (otherwise every two years).

A trust institution rated U.I.T.R.S. composite 3 at the last examination with total discretionary assets greater than \$100 million will be subject to an annual full-scope examination to be conducted either by

¹ U.I.T.R.S. refers to the rating system used by the federal supervisory agencies to assess the condition of trust institutions (F.R.R.S. 3-1576).

the Federal Reserve independently or jointly with the State. A trust institution rated U.I.T.R.S. composite 3 with total discretionary assets less than \$100 million will be subject to a full-scope examination every two years to be conducted either by the Federal Reserve independently jointly with the State.

A trust institution rated U.I.T.R.S. composite 4 or 5 at the last examination must be examined on a twice-a-year basis (every six months) until rated 3 or better, at least one of these two examinations must be full-scope and both must be conducted by the Federal Reserve independently or jointly with the State.

Full-scope, limited scope or targeted examinations should be conducted more frequently if deemed necessary by the Reserve Bank.

The trust activities of State chartered banks or trust companies applying for membership in the Federal Reserve System are to receive a full-scope examination by the Federal Reserve before membership is granted. Similarly, a full-scope trust examination by the Federal Reserve, independently or with the State, will be required within 12 months: following (1) the formation of a de novo State member bank or trust company, or (2) the change in control of a state member bank or trust company.

Transfer Agent Examinations²

A registered transfer agent rated TA composite A³ at the last examination, and servicing more than 500 issues, will be subject to a full-scope examination every two years, provided that the Reserve Bank has no reason to believe there has been a material change: and/or deterioration in the institution's management, condition, or character of business since the last examination, and all substantive issues commented upon in the last examination report have been satisfactorily resolved. Transfer agents rated TA composite A and servicing less than 500 issues will be subject to a full-scope examination every three years. Transfer agents rated TA composite B must be examined annually, and transfer agents rated TA composite C must be examined every six months. Newly registered transfer agents are to receive a full-scope examination by the Federal Reserve within 12 months of registration.

Registered Clearing Agency Examinations

All registered clearing agencies will be subject to full-scope examinations annually by the Federal Reserve.

Electronic Data Processing Examinations

The revised guidelines contained in Table A also apply to EDP Examinations conducted in state member banks⁴ and Edge Corporations. Those institutions rated EDP⁵ composite 1 or 2 at the last

² A bank's transfer agent activities are a separate service provided to customers, the size or volume of which is not necessarily related to commercial or trust department activities. Additionally, some organizations subject to Federal Reserve supervision are not organized as banks, but rather as, for example, securities processing subsidiaries of bank holding companies. Therefore, an examination frequency based on trust asset size is considered inappropriate. Instead, frequency is based on the total number of issues serviced as transfer agent.

³ TA rating refers to the rating system used by the Federal Reserve to assess the condition of registered transfer agents (F.R.R.S. 3-1577).

⁴ Including facilities management operations unless examined under the MDPS schedule.

⁵ EDP rating refers to the rating system used by the federal supervisory agencies to assess the condition of EDP operations (F.R.R.S. 3-1515).

with assets greater than \$500 million are subject to a full-scope examination every two years to be conducted either by the Federal Reserve independently or jointly with the State, provided that the Reserve Bank has no reason to believe that there has been a material change and/or deterioration in the institution's management, condition, or character of business since the last examination, and all substantive issues commented upon in the last examination report have been resolved satisfactorily. Institutions rated EDP composite 1 or 2 with total assets between \$100 and \$500 million are subject to a full-scope examination every three years by the Federal Reserve, provided an acceptable State examination is conducted in the interim (otherwise every two years). An institution rated EDP composite 1 or 2 with total assets less than \$100 million is subject to a full-scope examination every four years by the Federal Reserve, provided an acceptable State examination is conducted in the interim (otherwise every two years).

State member banks and Edge Corporations rated EDP composite 4 or 5 at the last EDP examination must be examined on a twice-a-year basis (every six months) until rated 3 or better; at least one of the two examinations must be full-scope and both must be conducted by the Federal Reserve independently or jointly with the State.

State member banks and Edge Corporations rated EDP composite 3 at the last EDP examination with total assets greater than \$100 million will be subject to an annual full-scope examination to be conducted either by the Federal Reserve independently or jointly with the State. An institution rated EDP composite 3 with total assets less than \$100 million will be subject to a full-scope examination every two years to be conducted either by the Federal Reserve independently or jointly with the State.

State member banks and Edge Corporations rated EDP composite 3 at the last EDP examination with total assets greater than \$100 million will be subject to an annual full-scope examination to be conducted either by the Federal Reserve independently or jointly with the State. An institution rated EDP composite 3 with total assets less than \$100 million will be subject to a full-scope examination every two years to be conducted either by the Federal Reserve independently or jointly with the State.

Independent servicers, bank service corporations and other data centers rated EDP composite 1 or 2 that process major applications for state member banks are subject to an 18 month examination cycle. Annual examinations are to be conducted in data centers rated EDP composite 3. Data centers rated EDP composite 4 or 5 are to be examined on a twice-a-year basis (every six months); one of the two examinations may be a limited-scope or targeted examination.

Newly organized data centers must be examined within one year of the start of operations.

Multi-regional Data Processing Servicers (MDPS) with an EDP composite rating of 1 or 2 are to be examined within an 18 month time frame. The examinations are to be conducted concurrently with the lead bank, where possible. Institutions with an EDP composite rating of 3, 4, or 5 require ongoing supervision. No more than 12 months should elapse between examinations.

Full-scope, limited scope or targeted examinations may be conducted more frequently if deemed necessary by the Reserve Bank. For each of these types of examinations a report is to be completed and submitted to the examined institution. Reserve Banks are asked to send a copy to the Clearing Unit at the Board.

Municipal Securities Dealers

Municipal securities dealer activities should be examined at least once every 24 months, as required by Municipal Securities Rule making Board (MSRB) rules, provided that: (1) as of the date of the last examination there were no significant deficiencies in the bank's compliance with MSRB rules, Board rules, or related securities laws; (2) management of municipal securities dealer activities is believed to be capable and stable; and (3) the Reserve Bank has no reason to believe that there has been a major change in the type and scope of activities conducted by the dealer department operations since the last examination.⁶ Dealer banks failing to meet the preceding criteria should be examined on an annual, or even more frequent, basis depending on the severity of compliance problems or changes in circumstances.

With respect to de novo municipal securities dealer operations, Reserve Banks should attempt to conduct the first examination within six months of dealer registration. It is vital to promptly examine new entrants to the industry to ensure compliance with the panoply of MSRB and other rules governing these specialized activities.

Implementation of these procedures should begin with the scheduling of remaining 1986 examinations, where practicable. Since only nominal changes are involved and examination resource impact should not be adversely affected, full implementation should be achieved in 1987.

/s/Welford S. Farmer
Deputy Director

Attachments

CROSS-REFERENCE: SR-665, SR-678, SR-33, SR-729/TR-53 SR 85-28

SUPERSEDES: SR-665, SR-678, TR-33, SR-729/TR-53 (in pertinent part)

⁶ Currently, no state banking department examinations of municipal securities dealers are conducted, and thus there is no provision for Joint examinations of this activity.

TABLE A

FREQUENCY AND SCOPE OF EXAMINATIONS OF TRUST INSTITUTIONS AND EDP
EXAMINATIONS OF STATE MEMBER BANKS AND EDGE CORPORATIONS

Asset/ Rating	\$500 million and larger	\$100mm-500mm	\$100mm
1 or 2	Full-scope required Every two years (FR or Joint).	Full-scope (FR) required (FR) required every three years provided an acceptable state exam- nation is conducted in the interim. Otherwise Otherwise full-scope is Required every two years.	Full-scope (FR) required (FR) required every four years provided an acceptable state exam- ination is conducted the interim. full-scope is Required every two years.
3	Full-scope required annually (FR or Joint)		Full-scope required every two years (FR or Joint)
4 or 5	Required on a twice-a-year basis (every six months); one must be full-scope, one may be limited-scope or targeted. (Both must be FR or Joint)		

Special Characteristics:

1. New member banks or trust companies: Full-scope FR examination required before membership granted.
2. Change in control: Full-scope FR examination required within 12 months.

Notes:

1. Asset Size refers to total discretionary trust assets for purposes of the frequency of trust examinations.
2. A full-scope examination covers all areas of interest to the Federal Reserve in depth; a limited-scope examination will review all areas of activity covered by a full-scope examination, but less intensively; targeted examinations will focus intensively on one or two activities.
3. Joint examinations are conducted by the Federal Reserve and the State, simultaneously, generally with one joint report being prepared.

TABLE B
FREQUENCY AND SCOPE OF EXAMINATIONS OF TRANSFER AGENTS

Rating	Larger Institutions	Smaller Institutions
A	Full-scope required every two years.	Full-scope required every three years.
B	Full-scope required annually.	
C	Full-scope required on a twice-a-year basis (every six months).	

Special Characteristics:

1. Newly registered transfer agents: Full-scope FR examination required within 12 months.

Notes:

1. Larger institutions refers to those transfer agents which service 500 or more issues; smaller institutions refers to those which service less than 500 issues.
2. Currently, no state examinations of registered transfer agents are conducted, thus there is no provision for Joint examinations.
3. Certain special situations may warrant deviation from the above matrix, e.g., a large mutual fund custodial business. In these cases Reserve Banks maintain discretion in determining examination frequency, based upon considerations such as volume and nature of activity.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 88-2 (FIS)
January 21, 1988

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

SUBJECT: End-User Computing

The widespread use of microcomputers by financial institutions has provided end-users with direct access to sensitive and valuable bank data. The federal banking agencies are concerned, that in some financial institutions, the use of microcomputers may have out paced the implementation of controls. Accordingly, the agencies have agreed to alert institutions subject to their supervision to the risks associated with end-user computing and the appropriate controls for safe and sound processing of data within the microcomputer environment.

Please distribute the enclosed document on end-user computing to your examination staff and each State member bank in your district.

/s/Stephen C. Schemering
Deputy Associate Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 88-33(FIS)
November 30, 1988

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

SUBJECT: Supervisory Policy on Large-Scale Integrated Financial Software Systems (LSIS)

Because of the potential problems associated with large-scale integrated financial software systems, the regulatory agencies are issuing a joint policy statement to specifically identify the risks as well as management's responsibilities with respect to acquisition and/or development of such systems. The problems encountered by institutions include cost overruns, delays in implementation and internal control issues, as the attached statement indicates. In certain instances, financial institutions were able to implement only a portion of these systems or completely abandoned the project after considerable capital outlays. In view of the supervisory concerns, the agencies have agreed to alert institutions subject to their supervision to the risks associated with these systems.

Please distribute the enclosed document on large-scale integrated financial software systems to bank holding companies over \$1 billion and all State member banks in your district. Any questions regarding LSIS should be directed to Vince Provenzano (X3359) or Kathleen M. O'Keefe (X3412).

/s/James I. Garner
Assistant Director

Enclosure

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 88-37(FIS)
December 28, 1988

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

**SUBJECT: Disclosure of Numeric Composite Examination and Inspection Ratings to
Examined/Inspected Institutions**

On December 16, 1988, the Board approved a proposal, previously approved by the Conference of Presidents of the Federal Reserve Banks, for examiners to disclose the composite numeric rating assigned in an examination or inspection to the senior officials and boards of directors of examined/inspected institutions as part of the examination/inspection report process. Accordingly, effective immediately, composite numeric ratings assigned by examiners during examinations of state member banks, Edge Act and Agreement Corporations, overseas branches of U.S. banking organizations and inspections of bank holding companies are to be disclosed. Composite ratings that are assigned in the examination of trust activities, data processing, and compliance with the consumer laws and the Community Reinvestment Act are also to be disclosed to the appropriate officials of the examined institution.

The disclosure of the rating should be made in the summary sections of examination and inspection reports as well as in the summary reports prepared for boards of directors of examined/inspected institutions. In conjunction with disclosing the ratings, examiners and/or supervisory officials should explain clearly the meaning of the ratings. This will be of particular importance in the case of trust ratings, in that these ratings are assigned on a different scale than are commercial examination ratings. In addition, a rating should not be disclosed to an institution until it has been formally approved by appropriate senior Reserve Bank supervisory officials.

In disclosing the ratings, it should be made clear that they are part of the overall findings of an examination/inspection, and are confidential.

/s/William Taylor
Staff Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 89-16(FIS)
August 1, 1989

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Interagency Policy on Contingency Planning for Financial Institutions

Enclosed is a copy of the Interagency Policy on Contingency Planning for Financial Institutions which is the result of an EDP Symposium conducted in September, 1988. In view of the increasing dependence on automated systems, it is imperative that financial institutions address the inherent risks associated with the loss or extended disruption of services. Accordingly, the primary purpose of this statement is to alert directors and management of financial institutions and service bureaus of the need for in-house contingency planning and also for the coordination of contingency planning between financial institutions and their service bureaus where applicable. It also addresses various issues and responsibilities relating to the development and implementation of such plans.

You are requested to distribute a copy of this policy to all bank holding companies, state member banks, Edge Act Corporations, and service bureaus in your District. Any questions regarding this policy should be directed to Vince Provenzano (202-452-3359).

/s/James I. Garner
Assistant Director

See FFIEC Policies SP-5 for details.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

**DIVISION OF BANKING
SUPERVISION AND REGULATION**

**SR 89-21(FIS)
September 26, 1989**

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: EDP Examination Data Base

Effective immediately, it is no longer necessary to prepare and forward a copy of the "Summary of EDP Evaluation" form for each EDP examination as required under the provisions of SR 83-16 (FIS), dated April 7, 1983. The FDIC has dispensed with requesting this form from the other federal banking agencies.

Questions or comments concerning the foregoing matter should be addressed to Vince Provenzano (202 452-3359).

/s/James I. Garner
Assistant Director

Supersedes: SR 83-16 (FIS)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

**DIVISION OF BANKING
SUPERVISION AND REGULATION**

**SR 90-5
January 24, 1990**

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Interagency Statement on EDP Service Contracts for Financial Institutions

Enclosed is a copy of the Interagency Statement on EDP Service Contracts for Financial Institutions. The intention of this issuance is to advise the financial community of the risks associated in contracting for EDP services and/or failing to properly account for certain contract provisions. Further, the Financial Institutions Reform, Recovery and Enforcement Act of 1989, among other things, prohibits FDIC insured depository institutions from entering into contracts if the performance of such contract would adversely affect the safety and soundness of the institution.

Please distribute this statement to all bank holding companies, state member banks, Edge Act Corporations and service bureaus in your district. Any questions regarding this policy should be directed to Vince Provenzano (202) 452-3359.

/s/James I. Garner
Assistant Director

See FFIEC Policies SP-6 for details.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

**DIVISION OF BANKING
SUPERVISION AND REGULATION**

**SR 91-21 (FIS)
October 11, 1991**

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: EDP Interagency Examination, Scheduling and Distribution Policy

Enclosed is a copy of the revised EDP Interagency Examination, Scheduling and Distribution Policy which was approved by the FFIEC Task Force on Supervision at their September 1991 meeting. This policy supersedes SR - 475, July 19, 1978; SR 492, October 11, 1978; and SR 79 - 549, June 4, 1979 and is effective immediately.

If you have any questions, please contact Vince Provenzano at 202-452-3359.

/s/James I. Garner
Assistant Director

Enclosure

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 93-25 (FIS)
May 14, 1993

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Interagency Supervisory Statement on EFT Switches and Network Services

Enclosed is a copy of the Interagency Supervisory Statement on EFT Switches and Network Services which is the result of an FFIEC sponsored EDP Symposium. In view of the increased use of switch and network services to expand traditional methods of consumer banking, it is important that financial institutions address a number of concerns that arise in this context. As such, this statement was prepared to alert directors and management of financial institutions and service bureaus of the need for adequate controls, appropriate contractual arrangements and safe and sound settlement procedures.

The FFIEC issued a press release on April 7, 1993, indicating that the policy statement had been adopted. On April 8, 1993, "camera ready copy" of the press release was distributed to the president of each Federal Reserve Bank by the Board's Office of the Secretary. It was intended that the statement be distributed to all bank holding companies, state member banks, Edge Act Corporations, state licensed branches and agencies of foreign banks and automated data processing service bureaus in your District.

Any questions regarding this policy should be directed to Don Vinnedge (202-452-2717).

/s/ James I. Garner
Deputy Associate Director

ATTACHMENTS MAY BE OBTAINED FROM FEDERAL RESERVE BANK

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 94-2 (FIS)
January 13, 1994

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Electronic Imaging Systems

The FFIEC's Task Force on Supervision recently approved for distribution to the agencies and their examiners the attached statement on "Control and Security Risks in Electronic Imaging Systems" which was prepared by the EDP Supervision Subcommittee following a symposium on the subject. The statement addresses risk and control issues inherent in a growing, highly technical speciality area that EDP examiners are encountering more frequently during examinations of banks and service centers.

Please distribute the statement to your EDP supervision staff and examiners in order to enhance their familiarity with the subject. The statement may be made available to banks and others upon request or where warranted. Should you have any questions regarding this statement, please contact Blaine Jones (202-452-3759).

/s/ Howard A. Amer
Assistant Director

See FFIEC Policies SP-10 for details.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 95-7 (SPE)
February 9, 1995

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Enhanced Supervision Program for Multiregional Data Processing Servicers

The attached policy statement on the "Enhanced Supervision Program for Multiregional Data Processing Servicers (MDPS)" was recently approved by the FFIEC's Task Force on Supervision in order to improve the agencies' understanding of the condition and operations of large EDP service centers between full-scope examinations. This program amends the existing "Interagency EDP Examination, Scheduling, and Report Distribution Policy Statement (SP-1)" which requires that the condition of MDPS vendors "...be monitored between examinations through periodic visitations and progress reports..."

In this regard, the attached statement is intended to formalize many of the agencies' interim monitoring practices and procedures that have evolved informally over the three years since the last revision to SP-1. It is also intended to provide for the uniform implementation of this requirement on an interagency basis.

The statement is effective immediately. Please distribute it to your EDP supervision staff and examiners. It may also be provided to MDPS organizations and others with an interest in EDP supervision policy. Should you or your staff have any questions, please contact Blaine Jones at the Board at (202) 452-3759.

/s/ Howard A. Amer
Assistant Director

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 95-48 (SPE)
(Revised ¹)
November 9, 1995

TO THE FIRST VICE PRESIDENT AND OFFICER IN CHARGE
OF SUPERVISION AT EACH FEDERAL RESERVE BANK

SUBJECT: Fedwire Third-Party Access Policy

The Federal Reserve Board has approved certain modifications to its Fedwire Third-Party Access Policy (Policy) in order to clarify its applicability and to reduce the administrative burden on Fedwire participants attributable to several of its earlier provisions. These changes, which are described in the attached *Federal Register* notice, became effective August 10, 1995. Existing Fedwire third-party access arrangements are to comply with the revised policy by March 1, 1996.

Examination Procedures

Depository institutions that outsource either their Fedwire funds transfer or book-entry securities transfer operations may have to implement new operating procedures in order to comply with the requirements contained in the Policy. The revised Policy will also necessitate modifications to the System's existing examination procedures used by safety and soundness and EDP examiners to review electronic funds transfer and book-entry securities transfer operations. In this regard, supervision staff is currently reviewing the System's program for the examination of Fedwire operations.

Upon completion, the review will result in modifications to examination procedures that address the requirements of the Board's revised Policy. Until the revised examination procedures are finalized and approved for use, examiners assigned to review Fedwire operations at a bank that has outsourced any part of its operation to a third party should supplement existing procedures by making a special effort to focus attention on the outsourcing arrangement in order to determine that the bank is in compliance with the modified policy.

Examiners should pay particular attention to assess the bank's compliance with the policy's "termination back-up" requirement now applicable only in those cases where the Fedwire participant outsources to an **unaffiliated** third party. For a broader discussion of the issues pertaining to back-up requirements, see section F of the attached *Federal Register* notice.

¹ This letter revises the version issued on October 10, 1995, in order to clarify the review and approval process.

Review and Approval Process

The Policy is implemented through the Reserve Bank's funds transfer and book-entry securities transfer operating circulars, "Funds Transfers Through Fedwire" and "Book-Entry Securities Account Maintenance and Transfer Services," respectively. The Policy establishes conditions that must be met by domestic banks and U.S. branches and agencies of foreign banks that choose to outsource their Fedwire operations to a domestic service provider. Pending Board review of the issues pertaining to the use of a service provider located in a foreign country, the Federal Reserve will not authorize requests for foreign Fedwire third-party access arrangements, including those to foreign affiliates, branches or parent companies.

In accordance with the Policy, depository institutions that desire to outsource their Fedwire funds transfer or book-entry securities transfer operations to a domestic third-party service provider must receive approval from the Reserve Bank before establishing such an arrangement. In order to initiate this process, the depository institution (participant) must submit a request for a "Letter of Authorization" to its Reserve Bank. Such requests are ordinarily submitted to the Reserve Bank's operations staff. Reserve Banks are requested to establish appropriate internal review procedures for third-party access requests in order to ensure effective coordination between the operations and supervisory functions.

To date, most of the requests to establish Fedwire third-party access arrangements have been between affiliated parties. Pursuant to the modifications to the Policy that became effective August 10, 1995, Reserve Banks are now authorized to approve such requests without further review by Board staff. Given that the Policy is less restrictive for outsourcing arrangements to affiliates, the Reserve Bank need not require additional supporting documentation from the participant beyond its request form before approving the request. In effect, the participant's affirmations contained on the request form evidence its position that it has met the Policy's requirements. As part of the subsequent examination process, the participant's compliance with the Policy will be subject to review.

Board staff review of Fedwire outsourcing proposals continues to be a requirement in those cases where the participant is a subsidiary of a Top 50 bank holding company that proposes to outsource to an **unaffiliated** third-party service provider. In such cases, the Director of the Division of Reserve Bank Operations and Payment Systems (RBOPS) and the Director of the Division of Banking Supervision and Regulation (BS&R) must review the proposal and offer no objection before the proposal can be approved by the Reserve Bank. Such proposals should be submitted to the Director of RBOPS who will coordinate review with BS&R at the Board. Given the complexity of issues associated with outsourcing to unaffiliated third parties by large banking organizations, Reserve Banks should obtain from the participant more specific information concerning the participant's ability to comply with the Policy on an ongoing basis prior to recommending approval to Board staff. Special attention should be given to a review of the participant's plans to comply with the Policy's termination back-up requirement.

Comparably, Reserve Bank supervision staff should be actively involved, together with Reserve Bank operations staff, in the review of all proposals to outsource Fedwire operations to **unaffiliated** third parties, regardless of the size of the bank or its parent, to assess the participant's ability to comply with the Policy.

Distribution to Staff

Please distribute this SR letter and the attached *Federal Register* notice containing the Board's policy

statement to your supervision and operations staff, particularly those safety and soundness and EDP examiners that may be assigned responsibility for the examination of a bank's Fedwire operation and those staff that may be responsible for the review and analysis of Fedwire outsourcing proposals.

Should you or your staff have any questions regarding Fedwire supervisory matters, please contact Howard Amer, Assistant Director, BS&R, at extension 2958, or Don Vinnedge or Blaine Jones in the Trust/EDP Supervision Section at extension 2717 or 3759, respectively. Questions pertaining to Fedwire operations should be directed to Jeff Stehm or Lisa Hoskins in the Fedwire Section at extension 2217 or 3437, respectively.

/s/ James I. Garner

Deputy Associate Director
Division of Banking
Supervision and Regulation

/s/ Louise L. Roseman

Associate Director
Division of Reserve Bank Operations and
Payment Systems

Attachment:

Federal Register – Federal Reserve Payment
System Risk Policy

Cross Reference: Commercial Bank Examination Manual Section 4180
1994 FFIEC Information Systems Examination Handbook Section 8