Regulatory Examination Process

FEDERAL DEPOSIT INSURANCE CORPORATION

INSURING AMERICA'S FUTURE

Objective

- To provide general examination-related concepts and terms used by regulators

Regulators

- Most common regulatory agencies that will interact with your bank:
  - FDIC

    Insures deposits and conducts examinations
  - State Banking Agency

    Issues charters and conducts examinations
  - The Federal Reserve

    Regulates bank's holding company

Examination Process

- The bank receives a request letter for various schedules and information such as:
  - Balance sheet and income statement
  - Written policies and procedures
  - Latest board packet
  - Board minutes
  - Reports (Past Due, Audits, Problem Loans etc.)

Examination Process Continued

- *Off-Site* review of information requested from the bank and gathered from other sources
- *On-Site* review which includes in-depth discussions with management
- “Exit Meeting” where findings and ratings are presented to management
- Examiners may also meet with the board to discuss findings
- The FDIC issues a written Report of Examination

Examination Ratings

- Reflects the condition of the bank or areas assessed and are assigned to an institution at each examination
  - Composite Rating: overall rating based on the essential component factors for Safety and Soundness ("CAMELS") and the bank's "CMS" for Compliance
  - Component Ratings: specific to the Safety and Soundness CAMELS components

Rating Scale

- Composite and component ratings are each assigned based on a 1 to 5 numerical scale
  - “1” indicates the highest rating, strongest performance and risk management practices <u>or</u> strongest compliance position, and least degree of supervisory concern
  - “5” indicates the lowest rating, weakest performance, inadequate risk management practices <u>or</u> substantial noncompliance with consumer statutes and regulations, therefore the highest degree of supervisory concern

Types of Examination

- Safety & Soundness
- Specialty Examinations, such as Trust and Information Technology
- Compliance
- Community Reinvestment Act

Safety & Soundness Exams - Focus

- Focuses on the bank's financial performance and management practices in relation to the CAMELS components:
  - Capital
  - Asset Quality
  - Management
  - Earnings
  - Liquidity
  - Sensitivity to Market Risk

Safety & Soundness Exams – CAMELS

- Capital: Absorbs losses, supports growth, and provides depositor confidence
- Asset Quality: Reflects the quantity of existing and potential credit risk associated with loans, investments and other assets and off-balance sheet items
- Management: The board and senior management of the bank
- Earnings: The ability to generate a return on assets sufficient to remain competitive, fund expansion and augment capital
- Liquidity: The ability to accommodate decreases in deposits and funding increases in assets, both at reasonable costs
- Sensitivity to Market Risk: Risk resulting from interest rate changes and other factors

Safety & Soundness Exam - Frequency

- Federal law requires that banks receive annual Safety & Soundness examinations
- Extension of the examination interval to 18 months if a bank:
  - Has a Camels Composite Rating of “1” or “2” and has less than $500 million in assets
  - Is Well Capitalized for Prompt Corrective Action purposes
  - Has management composite rating of “1” or “2”
  - Is not subject to a formal enforcement action
  - Has not experienced a change in control in the preceding 12 months

Trust & Information Technology (Specialty) Exams - Frequency

- Governed by policy, rather than regulation
- Usually concurrent with Safety & Soundness exams, but may occur separately
- Conducted at FDIC independent exams and exams with the State (joint exams) where the FDIC is the lead
- State regulatory agencies may perform specialty exams at their independent exams and during joint exams where the State is lead

“Embedded” Exams

- Safety and Soundness Reports of Examination will include findings from the Bank Secrecy Act review and can include “specialty” examination (i.e. Information Technology or Trust) information and ratings

- If the condition of a specialty area is less than satisfactory, a separate cover Report of Examination may be issued

Common “Embedded” Information

- Bank Secrecy Act: Targets the bank’s compliance with regulations addressing large cash transactions and the bank’s anti-money laundering program

- Information Technology: Assesses the bank’s data processing environment, focusing on the components of audit, management, development and acquisition and support and delivery

- Trust: Focuses on the ability of management to identify, measure, monitor and control the risks of its fiduciary operations

Compliance Exams

- Primary method to determine if the institution is meeting its responsibility to comply with federal consumer protection laws and regulations, including Fair Lending statutes and regulations

- Blends risk-focused and process-oriented approaches

Compliance Exams - Focus

- Compliance Management System (CMS) which is comprised of the following components:
  - Board and Senior Management Oversight
  - Compliance Program
    - Policies and Procedures
    - Training
    - Monitoring
    - Consumer Compliance Response
  - Compliance Audit

Community Reinvestment Act (CRA) Evaluations

- A CRA evaluation is used by the FDIC to:
  - Assess the bank's record of helping to meet the credit needs of its entire community, consistent with safe and sound banking operations
  - Evaluate an application from the bank for a deposit facility
- The bank will receive a written, publicly-available "Performance Evaluation"
- Uses a separate rating system

CRA Evaluations – Continued

- The bank is subject to one of three different evaluation methods based on its asset size for the previous two year-ends:
  - Small Institution (<$250 million)
  - Intermediate Small Bank ($250 million ≤ $1 billion)
  - Large Bank (>$1 billion)
- Other evaluation methods include:
  - Wholesale or Limited-Purpose
  - Strategic Plan

CRA Ratings =

- One composite and two or more individual test ratings for Intermediate Small & Large Banks
- Small Banks only receive a composite rating

<u>Composite Rating</u>
Outstanding
▼
Satisfactory
▼
Needs to Improve
▼
Substantial Noncompliance

<u>Individual Test Ratings</u>
Outstanding
▼
High Satisfactory
▼
Low Satisfactory
▼
Needs to Improve
▼
Substantial Noncompliance

Compliance/Community Reinvestment Examinations

- Frequency depends upon asset size and ratings
- Conducted independently or concurrently with a Safety and Soundness examination

Compliance/Community Reinvestment Examinations - Frequency

Institutions With Total Assets Of $250 Million or Less

CRA/Compliance Examination Frequency (in months)

CRA Rating → ↓Compliance Rating	Outstanding	Satisfactory	Needs to Improve	Substantial Noncompliance
1	60 – 72 (CRA) *30 – 36 (COMP)*	48 – 60 (CRA) *24 – 30 (COMP)*	12 - 24	12
2	60 – 72 (CRA) *30 – 36 (COMP)*	48 – 60 (CRA) *24 – 30 (COMP)*	12 - 24	12
3	60 – 72 (CRA) *12 – 24 (COMP)*	48 – 60 (CRA) *12 – 24 (COMP)*	12 - 24	12
4	60 – 72 (CRA) *12 (COMP)*	48 – 60 (CRA) *12 (COMP)*	12	12
5	60 – 72 (CRA) *12 (COMP)*	48 - 60 (CRA) *12 (COMP)*	12	12

Compliance/CRA Exam – Frequency Continued

Institutions With Total Assets Greater Than $250 Million

CRA/Compliance Examination Frequency (in months)

CRA Rating → ↓Compliance Rating	Outstanding	Satisfactory	Needs to Improve	Substantial Noncompliance
1	24 - 36	24 - 36	12 - 24	12
2	24 - 36	24 - 36	12 - 24	12
3	12 - 24	12 - 24	12 - 24	12
4	12	12	12	12
5	12	12	12	12

Director Participation

- During examinations, the FDIC invites directors to:
  - Attend discussions with management
  - Discuss any other issues with the examination staff

Examiners May Attend Board Meetings

- At the examination's conclusion to present findings
- At least once every three years as required by the FDIC
- When adverse findings are identified during the examination
- Upon the request of the board

Recap

- Banks are subject to Safety and Soundness, Compliance and CRA examinations
- The examination process includes both off-site and on-site analyses
- Findings and ratings will be presented at the conclusion of the examination
- Directors are invited to participate