Federal Deposit Insurance Corporation
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Financial Institution Letter
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New Classification System for Citing Violations in Reports of Examination

Summary: The FDIC's Division of Depositor and Consumer Protection has revised the classification system for citing violations identified during compliance examinations to better communicate to institutions the severity of violations and to provide more consistency in the classification of violations cited in Reports of Examination. Violations identified during an examination will be assigned to one of three levels based primarily on the impact to consumers. The change is intended to help focus the institution's attention on the most significant issues identified during the examination and place violations that are more technical in nature in the appropriate perspective. This new three-level violation system replaces the current two-level system and will be used in examinations started on or after October 1, 2012.

Statement of Applicability to Institutions with Total Assets under $1 Billion: This Financial Institution Letter applies to all FDIC-supervised financial institutions.

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FDIC-Supervised Institutions

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Note:
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Highlights:

- The key purpose of the classification system in the Compliance Report of Examination is to effectively communicate to the institution the level of severity of the violations cited so that the institution can appropriately prioritize efforts to address identified issues.
- Level 3/High Severity violations include violations that may result in restitution to consumers in excess of $10,000 and pattern and practice violations of anti-discrimination laws.
- Level 2/Medium Severity violations include violations resulting in potential restitution to consumers in an amount below the Level 3 threshold and other systemic or recurring violations.
- Level 1/Low Severity violations involve isolated or sporadic violations. Level 1 violations that are adequately addressed during the examination and that do not indicate weakness in the compliance management system will not be included in the Report of Examination.
- The new classification system will become effective for examinations started on or after October 1, 2012.

New Classification System for Citing Violations in Reports of Examination

Background: The violations pages in the Compliance Report of Examination serve as the institution's official record of violations identified during an examination. Because different types of violations present different levels of risk to consumers and to institutions, a method of classifying violations is necessary to communicate the FDIC's level of concern regarding the violations identified. The FDIC has developed a new system of classifying violations that replaces the previous two-level system, which designated violations as "Significant" or "Other."

New Classification System: The new classification of compliance violations is a three-level system that provides greater clarity to the institution regarding the severity of the violation. The three categories for violations are:

1. **Level 3/High Severity:** Violations that have resulted in significant harm to consumers or members of a community. These violations typically result in a request or a requirement that the institution provide restitution in excess of $10,000 (in aggregate), and also include any pattern or practice violations of anti-discrimination provisions, including redlining or widespread discouragement.

2. **Level 2/Medium Severity:** Violations reflecting systemic, recurring, or repetitive errors that represent a failure of the bank to meet a key purpose of the underlying regulation or statute. These violations may have had a small, but negative, impact on consumers or have the potential to have a negative impact if uncorrected. Level 2/Medium Severity violations may also include those resulting in potential restitution in an amount below the Level 3 threshold.

3. **Level 1/Low Severity:** Violations that are isolated or sporadic, or systemic violations that are unlikely to affect consumers or the underlying purposes of the regulation or statute. These violations are typically due to individual instances of failure to follow established procedures or minor errors in the implementation of reasonable procedures to meet obligations of the regulation or statute.

Report of Examination Treatment: Level 3/High Severity or Level 2/Medium Severity violations will be described in the Report of Examination under distinct headers, with Level 3 Violations appearing first on the violations pages. The discussion of these violations will include institution management's response to each violation. Level 1/Low Severity violations will be listed with a blanket statement indicating management's actions or intentions to address the noted violations. Level 1 violations that are adequately addressed during the examination and that do not indicate weakness in the compliance management system will not be listed in the Report of Examination.

With this new classification system and its presentation in the Report of Examination, the FDIC seeks to address concerns raised by the industry in post-examination surveys and during regulatory outreach events about the focus and portrayal of violations within the context of the examination findings. Institution management should find the new approach helpful as they strive to focus on areas of greatest concern and take prompt and appropriate corrective action.

Effective Date: The new violation classification system will become effective for all examinations started on or after October 1, 2012.

Mark Pearce
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Division of Depositor and Consumer Protection